Banks and Secured Lending:
Environmental Risks and Due Diligence

A dissertation presented

by

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SUMMARY

In the 1990s and early 2000s lender liability for the remediation of contaminated land was considered the greatest environmental risk for lenders. The threat of liability from Part IIA of the Environmental Protection Act 1990 initially drove the introduction and use of environmental due diligence in banks. But instances of such lender liability are now considered highly unlikely.

It is because of the low risk of lender liability and the empirical knowledge gaps that existed in the literature basis that this research was necessary. The overarching research question of this thesis examines the lenders' current perceptions of the threat of the environmental risks, as well as the main drivers for the use and development of environmental due diligence in banks. Unique interview data were collected from fifteen semi-structured interviews with elite banking professionals to test the research premise.

There are three, primary environment-related risks. According to the banking respondents' data the current environmental risk ranking is: (1) lender liability – low risk; (2) the indirect risks – medium risk(s); and (3) reputational risk – high risk. Thus reputational risk has now replaced lender liability as the greatest risk.

The interview data further verify that banks use a range of due diligence techniques before and after the grant of loan finance to manage environmental risks. And further to this, the main driver for the continued use and development of environmental due diligence in banks has shifted from lender liability to reputational risk.

Originality is assured in this thesis by the use of the interview data. The research fills the empirical knowledge gaps that existed in the literature basis, and has implications for the theory, practice and future research opportunities in a number of areas, including law and banking.

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ABBREVIATIONS

ABI – Association of British Insurers

ABT – American Bank and Trust Company

AJA – Administration of Justice Act 1969

Berr - Department for Business, Enterprise and Regulatory Reform

BPT – Best Practicable Technique

BSA – Building Societies' Association

Cabernet – Concerted Action on Brownfield and Economic Regeneration Network

CCA 2008 – Climate Change Act 2008

CCL – Climate Change Levy

CD – Collevecchio Declaration

CERCLA 1980 – Comprehensive Environmental Response, Compensation, and Liability Act 1980

CFL – Circular Facilities Limited

CJEU – Court of Justice of the European Union

CML – Council of Mortgage Lenders

CN – Crest Nicholson

CPRE – Campaign to Protect Rural England

COSO – Committee of Sponsoring Organizations of the Treadway Commission

CSR – Corporate Social Responsibility

CVL – Creditors' Voluntary Liquidation

DCLG – Department for Communities and Local Government

DECC – Department of Energy and Climate Change

DEFRA – Department for Environment, Food and Rural Affairs

DoE – Department of Environment

DETR – Department for the Environment, Transport and the Regions

EA – Environment Agency

EA 1995 – Environment Act 1995

EA 2002 – Enterprise Act 2002

EC – European Commission

ECJ – European Court of Justice

EDD – Environmental Due Diligence

EDR 2009 – Environmental Damage Regulations 2009

EIA – Environmental Impact Assessment

ELD – Environmental Liability Directive

EP – Environmental Permit

EP – Equator Principles

EPA 1990 – the Environmental Protection Act 1990

EPR 2010 – Environmental Permitting Regulations 2010

EPFI – Equator Principles Financial Institution

ETS – Emissions Trading System

EU – European Union

FA 2001 – Finance Act 2001

FTSE – Financial Times and the London Stock Exchange

GAC – Generic Assessment Criteria

GSCM – Green Supply Chain Management

HMRC – Her Majesty's Revenue and Customs

HMT – Her Majesty's Treasury

IA 1986 – Insolvency Act 1986

IP – Insolvency Practitioner

IPO – Initial Public Offering

ISO – International Organization for Standardization

KYC – Know Your Client

LA – Local Authority

LBO – Leveraged Buy Out

LDA – London Development Agency

LEP – Local Enterprise Partnerships

Libor – London Interbank Offered Rate

LPA – Local Planning Authority

LPA Receiver – Law of Property Act Receiver

LPA 1925 – Law of Property Act 1925

LRR – Land Remediation Relief

MNA – Merger and Acquisition

NAP – Nitrates Action Programme

NGG – National Grid Gas

NGO – Non-governmental Organisation

NPPF –National Planning Policy Framework

NVZ – Nitrate Vulnerable Zone

ODPM – Office of the Deputy Prime Minister

OEDC – Organization of Economic Cooperation and Development

ONS –Office of National Statistics

Part IIA / Part IIA regime – Part IIA of the Environmental Protection Act 1990

PCPA – Planning and Compulsory Purchase Act 2004

PPG – Planning Policy Guidance

POCA - Proceeds of Crime Act 2002

POSH – Possibility of Significant Harm

PPI – Payment Protection Insurance

PPP – Public-Private Partnerships

PPS – Planning Policy Statement

PRP – Potentially Responsible Party

PWC – PriceWaterhouseCoopers

RBM – River Basin Management Plans

RDA – Regional Development Agency

RDAA – Regional Development Agencies' Act

RES – Regional Economic Strategy

RM – Redland Minerals

RSS – Regional Spatial Strategy

rWFD – revised Waste Framework Directive

SEAT – Sociedad Española de Automóviles de Turismo

SEED – Social, Ethical and Environmental Disclosure

SEPA – Scottish Environmental Protection Agency

SGV – Soil Guideline Value

SME – Small to Medium Sized Enterprise

SoPs – Statement of Principles

SoS – Secretary of State

SPOSH – Significant Possibility of Significant Harm

SPW – Swainsboro Print Works

SSSI – Site of Special Scientific Interest

SRI – Socially Responsible Investment

TCPA 1990 – Town and Country Planning Act 1990

TNC – Trans-national Corporation

TOX – Toxicology Report

UK – United Kingdom

USA – United States of America

US EPA – United States Environmental Protection Agency

WAC – Waste Assessment Criteria

WCA 1981 – Wildlife and Countryside Act 1981

WG – Welsh Government

WFD – Waste Framework Directive

WML – Waste Management Licence

WRA 1991 – Water Resources Act 1991

WT – Wilmott Trading

This is for my family.

Chapter 1:
Introduction

The purpose of this thesis is to assess the lenders' current perceptions of environmental risks and due diligence, providing an up-to-date and original contribution to the knowledge of the research area. It examines the research subject by analysing the English laws governing land pollution,[1] and through the use of qualitative interview data. The 'cut-off date' for the thesis is the date upon which it was submitted, 18 December 2014. Any reforms that have been made following the submission date will not be included in the analysis.

It is noteworthy that the thesis traces the research area back twenty-five years. From a chronological standpoint, this was necessary because the early 1990s represents the time at which UK banks first began to introduce specific environmental due diligence techniques into their risk management frameworks. Lender liability for land pollution acted as the original driver for the use of environmental risk management in banks. The initial system that was designed to register contaminated sites in the UK was section 143 of the Environmental Protection Act (EPA) 1990.[2] However, the section 143 registration system was rejected, and subsequent consultation led to the introduction of the contaminated land regime under Part IIA of the EPA 1990.[3]

[1] It is important to state that the legal system to which this thesis is directed is the English legal system. This is because particular chapters provide an in depth account of the English statutory and common laws governing land pollution.
[2] infra, ch 1, pg 76.
[3] Environmental Protection Act (EPA) 1990, pt IIA (hereafter, 'Part IIA', 'the contaminated land regime' or 'the Part IIA regime').

Lenders have a significant role to play in land redevelopment, since they provide the necessary funding for the remediation of contamination to take place. However, in a period of austerity the Coalition Government has designed and executed a political agenda that has adversely affected 'brownfield land'[4] redevelopment policy. Under PM David Cameron's Government there has been increased focus on, *inter alia*, governmental decentralisation through localism,[5] reducing 'unnecessary regulatory burdens',[6] and cutting public sector funding.[7] The changes that have been brought in by the current Government have stripped away many of the previous incentives for encouraging land redevelopment, and this is particularly so in relation to the UK's contaminated land regime.[8] This may be detrimental for future private sector investment in the redevelopment of affected land.

While lending to commercial clients seeking finance for land redevelopment, banks are capable of incurring a number of environmental risks. The four main risks are: (1) lender liability; (2) the indirect risks, i.e. credit and security risks; (3) reputational risk; and (4) market risk.[9] In response to the environmental risks lenders have introduced specific due diligence methods for assessing the eligibility of their borrowers.[10] Recent interview data suggest that the main driver for the banks' conduct of environmental due diligence has changed.[11] Therefore, a large proportion of the previous literature on

[4] See, Department for Communities and Local Government, *National Planning Policy Framework* (DCLG, March 2012) (hereafter, NPPF), para 111, sets out a 'brownfield test'.
[5] V Lowndes and L Pratchett, 'Local Governance under the Coalition Government: Austerity, Localism and the "Big Society"' (2012) 38(1) Local Government Studies 21.
[6] Department for Environment, Food and Rural Affairs, *Better Regulation: Red Tape Challenge* (*gov.uk*, no date) <https://www.gov.uk/government/collections/better-regulation-red-tape-challenge> accessed 20 August 2014.
[7] Lowndes and Pratchett (n 5) 25.
[8] EPA 1990, s 78A(2)(a)-(b).
[9] infra, ch 5, pp 221-237.
[10] infra, ch 6, pg 254.
[11] infra, ch 7, pp 291-327.

lender liability and environmental risk is outdated, and a knowledge gap existed in the empirical research surrounding the subject area. Despite the fact that the focus of the older writings has been primarily concerned with the direct lender liability threat posed to lenders by environmental law (e.g. Part IIA), this no longer reflects the perceptions of environmental risk currently held by the UK's bank lending community.[12] Now the reputational harm that may materialise from being in association with a polluting borrower or project is becoming an increasing concern.

This Chapter looks at why the thesis is necessary. It outlines the research question, provides a synopsis of the knowledge gaps in the literature, and evaluates the current challenges facing contaminated land policy in the economic downturn. Once the necessity of the research has been summarised, a description of the research method is given.

I. Research Questions

The overarching / key research question for the thesis is:

> Have the banks' perceptions of the threat of lender liability from environmental laws relating to land pollution, and the other environmental risks, changed over the last twenty-five years; and if so, what are currently the primary drivers for the use and development of environmental due diligence in loan finance transactions?

[12] infra, ch 5, pp 237-248.

The key research question is supplemented by a number of sub-questions (below). Deductive reasoning was the methodological approach used to devise the key research question and the sub-questions. A review of the literature basis concerning environmental risks and Part IIA of the Environmental Protection Act 1990 assisted in creating the specific questions that were to be tested by the empirical study. The sub-questions are:

1. What are the more threatening environment-related risks for the UK bank lending community today?

    - Does environmental legislation pose any real risk to bank lenders dealing with commercial customers seeking loan finance? And, if environmental legislation is not so significant, are there any other environment-related risks, i.e. environment-related risks affecting banks' credit and security interests or reputations?

    - How do banks currently rank the environmental risks in relation to the threat that they pose to the bank?

    - How have the lenders' perceptions of the environment-related risks changed over the last twenty-five years?

2. How do lenders exercise and shape their due diligence functions to manage and assess the environment-related risks?

- What are the main due diligence techniques used by lenders to manage environmental risk?

- When in the environmental due diligence process are the environmental risks assessed?

- At what time in the due diligence process is the use of environmental due diligence most important?

3. What are the main drivers for the use of environmental risk management in banks?

    - How have the drivers changed over the last twenty-five years, and are there other corporate social responsibility drivers?

    - What is presently driving the lenders' use of environmental risk management to assess commercial clients' eligibility?

    - What is the future of environmental due diligence in UK banks?

The table below explains how the above sub-questions link to the chapters / sections of the thesis, as well as to the key research question:

	How Sub-question Links into Chapter or Section	**How Sub-question Answers the Key Research Question**
Sub-question 1	• Chapter 1 tracks the perception shift that has occurred in the literature basis regarding environmental risks, and provides an economic overview to explain why lender liability may now be seen as low risk. • Chapters 2, 3 and 4 illustrate that the current national laws present only a limited liability threat. Specifically, Chapter 2 provides an outline of Part IIA of the EPA; Chapter 3 deals with the other, miscellaneous laws and 'emerging risks'; and Chapter 4 assesses the overlap between environmental law and insolvency law. • Chapter 5 ranks the threat of the environmental risks, and portrays that there are other environmental risks that can affect lenders and drive the use of their environmental due diligence.	Sub-question 1 intends to: • Demonstrate that lender liability is low risk, and that environmental due diligence is now be driven by other, 'emerging' environmental risks. • Display a contemporary 'risk ranking' of the environmental risks in relation to their threat of harm to the banks. In so doing, it fills the knowledge gap(s) that existed in the literature basis with empirical data. • Identify how the banks' perceptions of the threat of lender liability from environmental legislation, as well as the other environmental risks, have changed over the last twenty-five years.
Sub-question 2	• Chapter 6 and Chapter 7, section II track the technical capacity for lenders to exercise and shape their due diligence to manage environmental risks. It does this by evaluating the pre- and post-loan due diligence techniques that are currently being used by banks. • Chapter 7, section III examines the most important time at which to conduct environmental due diligence, i.e. before the contract of loan financing.	Sub-question 2 intends to: • Provide a general account of the practise of environmental due diligence in banks. This is necessary because, before analysing the drivers of due diligence, knowledge of the different due diligence techniques commonly used by banks is required. • Assist in understanding 'when' in the risk management process the use of environmental due diligence is the most important.

Sub-question 3	• Chapter 7, section I looks at the different drivers for environmental due diligence in banks. The data show how the lenders' perceptions of the due diligence drivers have changed over the last twenty-five years. • Chapter 7, section IV discusses the continued use of environmental due diligence in banks. The data suggest that there is a definite future for this form of due diligence. However, the extent to which it will grow and develop is uncertain.	Sub-question 3 intends to: • Analyse how the environmental due diligence drivers have changed over the last twenty-five years. It therefore aims to show what is currently the primary driver for environmental due diligence in banks. • Examine the future of due diligence in banks, and how this specific form of due diligence is expected to continue to develop and grow in response to the emerging environmental risks.

Broadly, the areas that the thesis is concerned with are lenders' liability and risks for environmental damage, and also the identification and remediation of contaminated land in England. The following section therefore provides a review of the literature concerning: (1) lender liability and environmental risk; and (2) Part IIA of the EPA 1990.

II. Gaps in the Existing Literature

A literature review was undertaken in the first year of the project to gain knowledge of the subject area, and to establish the rationale for the research. It was necessary to review literature surrounding: (1) lender liability and environmental risk; and (2) Part IIA of the EPA 1990. There are currently knowledge gaps in the literature concerning these two areas: (1) the majority of the writings were written in the 1990s and 2000s, and the literature is therefore outdated; and (2) the research area lacks contemporary

empirical data. Thus, an empirical-based study became a crucial feature of this research. The empirical data collected can be used to compare the lenders' current perceptions of environmental risks and due diligence with the writings of the past. The unique insights of the interviewees provide an original and up-to-date account of environmental risk and due diligence within twenty-first century bank lending.[13]

Tracking how the writings concerning bank lending and environmental risks have changed over the last twenty-five years contributes to establishing and answering the specific research questions for the thesis. Both the overarching research question and sub-question 1 are answered by this section. This is because the recent literature shows that a shift in the perceptions of lenders has occurred, and that the liability threat from Part IIA and the other, national environmental laws governing land pollution issues is sufficiently low. The more contemporary literature shows that environmental due diligence in banks is currently being driven by the reputational and indirect risks that banks can incur during loan finance.

A. Part IIA of the Environmental Protection Act 1990

The literature on Part IIA is outdated and highly analytical. This may be because the risk of direct lender liability for contaminated land has existed for more than a decade, and has become 'normalised' over time. Because the majority of the literature on Part IIA was published just before, and around, the time when the regime was brought into force (early 2000s), there existed a knowledge gap in the writings. While some of the literature assesses the potential liability that Part IIA could have for bank lenders, a

[13] The empirical data are mostly held in ch 7.

substantial part of the writing focuses on the contaminated land regime's structure and operation (see below). There is also no contemporary, empirical evidence to portray the lenders' current perception of Part IIA liability. Syms, for instance, conducted research into contaminated land for housing use in 1997.[14] His research showed, amongst other things, 'that traditional banks are more aware of the issues, and have appropriate mechanisms in place, than the building societies, or former societies which have converted to banks; none of the mechanisms discriminated against the redevelopment of contaminated land.'[15] Although Syms' research is relevant to this thesis, the reliability of the source can be questioned because of its age. The purpose of this thesis therefore is to update the research field's knowledge of Part IIA liability by employing empirical data.

The first research question suggests that environmental legislation presents no real risk for lenders in the UK. Evidence for this can be found in the Environment Agency's (EA) 2009 Report on the progress of Part IIA from 2000 – 2007.[16] The Report states that, out of the total number of sites so far determined, Part IIA has only remediated ten per cent of contaminated sites, with planning and voluntary remediation cleaning up the other ninety per cent of sites thus far remediated.[17] Before the regime came into force people working in the contaminated land market wondered whether it would be 'a damp squib or firecracker'.[18] Following the Part IIA's introduction the regime has

[14] P Syms, 'The Redevelopment of Contaminated Land for Housing Use' (1997) Housing Research 225 <http://www.jrf.org.uk/sites/files/jrf/h225.pdf> accessed 20 August 2014.
[15] ibid 225.
[16] Environment Agency, *Reporting the Evidence: Dealing with Contaminated Land in England and Wales; a review of progress from 2000-2007 with Part 2A of the Environmental Protection Act 1990* (EA 2009) <http://a0768b4a8a31e106d8b0-50dc802554eb38a24458b98ff72d550b.r19.cf3.rackcdn.com/geho0109bpha-e-e.pdf> accessed 3 December 2013.
[17] ibid 6.
[18] 'Legislative Comment: Damp squib or firecracker?' (1995) 5(4) PELB 32.

been compared to 'a monster under the bed'.[19] When the contaminated land regime was brought into force, the literature shows that its operation was, 'dogged by delays', as local authorities found it difficult to set up inspection strategies for identifying contaminated land.[20] Part IIA's insufficient impact is the reason why the recent consultation on the contaminated land regime was held by the Department for Environment, Food and Rural Affairs (Defra), and the Welsh Government (WG), in December 2010. This consultation concerned the need to update the contaminated land regime to give it more clarity. Amongst other things, Part IIA's statutory guidance was revised, and the new version was released on 6 April 2012.[21] The consultation generated literature that sought to question whether the updated version of the regime would increase its effectiveness.[22] In a 2013 article, Fogleman evaluates whether the changes that have been made to the new statutory guidance have had the effect of simplifying the document, or whether such changes have actually reduced the regime's future application.[23]

Notwithstanding the insignificant direct impact of Part IIA, there is literature to show how the regime has had indirect implications for a number of sectors. For example, in their article on the contaminated land regime's effect upon lawyers, Lee and Vaughan

[19] S Vaughan, 'Policy, Practice and Pollution: A Study of Contaminated Land Remediation' (MSc thesis, Cardiff University September 2008) 47.
[20] Ends, 'Contaminated land regime dogged by delays' (2007) Ends Report 388. See also, Ends, 'Councils still behind on contaminated land' (2009) Ends Report 409.
[21] Department for Environment, Food and Rural Affairs, *Environmental Protection Act 1990: Part 2A – Contaminated Land Statutory Guidance* (HM Government, 2012) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223705/pb13735cont-land-guidance.pdf> accessed 14 August 2014 (hereafter Defra 2012).
[22] See, for example: E Lees, 'The contaminated land regime – new guidance and a new philosophy?' (2012) 14(4) Env L Rev 267; Ends, 'Revised statutory guidance on contaminated land welcome' (2012) Ends Report 445; R Lee, S Sykes, A Pullman, P Davies and M Green, 'Protecting the land from pollutants' (2012) 1221 EG 86; and, M Barlow and S Tilling, 'Changes to the contaminated land regime' (2012) 199(Apr) IHL 9.
[23] V Fogleman, 'The new statutory guidance; simplification or reducing the application of Part 2A of the Environmental Protection Act 1990?' (2013) 15(1) Env L Rev 47.

suggest that the introduction of Part IIA subsequently led to a 'corporatisation' effect to occur within the legal realm.[24] They show how the regime's enactment created a niche in the legal world; as a consequence, environmental law became 'corporatised' as an individual area of practice in itself.[25] After reviewing Lee and Vaughan's paper, it makes one wonder how significantly the Part IIA regime has affected the various professions that have a place in the contaminated land market. For instance, has it made such professions conduct due diligence to manage and assess environmental risk?[26] What sort of impact has Part IIA had upon financial institutions, specifically? This research offers the most up-to-date account of Part IIA's impact, and how the banks' environmental risk management teams presently perceive it as a risk.[27]

What about Part IIA's structure and operation?[28] A number of journal articles and blogs have been highly useful for outlining Part IIA's structure.[29] Some of the literature suggests that the Part IIA regime's structure is over complex,[30] and, while applicable in theory, it creates a significant degree of 'uncertainty' for the under-resourced regulatory authorities when trying to enforce the regime in practice.[31] Lawrence and

[24] R Lee and S Vaughan, 'The Corporatisation of Environmental Lawyers' (2010) 17 IJLP 35.
[25] infra, ch 6.
[26] Read, for example, R Lee, 'Local Authority Inspection Strategies for Contaminated Land: Questions for Due Diligence' (2002) 3(4) Due Diligence and Risk Management 7.
[27] ibid.
[28] See, S Bell, D McGillivray and O Pedersen, *Environmental Law* (7th edn, OUP 2008); and R Turrell-Clark and S Tromans, *Contaminated Land* (2nd edn, Sweet & Maxwell 2008)).
[29] R Lee, 'Contaminated Land – remediation and liabilities' (1997) Mar JBL 172. See also, M Lee, 'New Environmental Liabilities: The Purpose & Scope of the Contaminated Land Regime and Environmental Liability Directive' (2009) 11(4) Env L Rev 264; R Lee, 'Part one of a detailed review of the Contaminated Land Regime' (*Eric-group,* 21 October 2011) <http://www.eric-group.co.uk/environmental_regulation_story.php?content_id=118> accessed 6 September 2013; R Lee, 'Contaminated Land Regime: Inspections' (*Eric-group,* 11 November 2011) <http://www.eric-group.co.uk/environmental_regulation_story.php?content_id=181> accessed 6 September 2013; and R Lee, 'Contaminated Land Regime: The Remediation Process' (*Eric-group,* 21/11/2011) <http://www.eric-group.co.uk/environmental_regulation_story.php?content_id=184> accessed 6 September 2013.
[30] Vaughan, 'Policy, Practice and Pollution' (n 19) 2.
[31] D Lawrence and R Lee, 'Permitting Uncertainty: Owners, Occupiers and Responsibility for Remediation' (2003) 66(2) Mod L Rev 261.

Lee state that: 'Because the regime is new and complex there is a range of issues open to doubt.'[32] In the more contemporary literature, this doubt has been replaced with criticism of the regime's effectiveness and operational capacity.[33] Part IIA has only generated a small amount of case law;[34] and not one single case concerns a lender being made directly liable for their borrower's contaminated land remediation. Hence, the research question states that environmental legislation has presented 'no real direct threat' for lenders based in the UK. Defra's statutory guidance defines the two types of liability that may occur under the Part IIA regime as: 'Class A' and 'Class B' liability.[35] Despite presenting a limited liability risk for lenders, Part IIA liability is capable of being transferred during corporate transactions.[36] Greenwood calls this, 'the environmental transaction.'[37] Thus, even though Part IIA liability is very unlikely to occur, lenders still remain at risk during their provision of loan finance to customers that own contaminated land. Literature concerning the case law on Part IIA liability shows how significantly costly the remediation requirements could be under the regime.[38] In relation to the case of *R (on the application of Crest Nicholson Residential*

[32] ibid 262.

[33] See, for example, E Lees, 'Interpreting the contaminated land regime: should the "polluter" pay?' (2012) 14(2) *Env L Rev* 98; S Vaughan, 'Contaminated land: fit for purpose? The progress of Part 2A to date' (2009) Mar Env L M 2; and S Vaughan, 'The contaminated land regime: still suitable for use?' (2010) 2 JPL 142.

[34] Lee, 'New Environmental Liabilities' (n 29) 264. This paper compares Part IIA of the EPA 1990 with Directive 2004/35 on environmental liability. In so doing, it provides a good account of some of the case law that Part IIA has generated.

[35] Defra 2012 (n 21), sec 7. See also, D Lawrence and R Lee, 'Talking 'bout my Generation: The Remediation Liability of Waste Producers' (2006) 8(2) Mod L Rev 93; and D Woolley, 'Contaminated land – the real world' (2002) January JPEL 5.

[36] Read, S Sykes, 'Contaminated land and property transactions: environmental information' (1997) 1(4) Journal of Property Development 171; V Fogleman, 'Transferring remediation liabilities in corporate transactions' (2001) 13(2) ELM 83; and, GI McGregor, 'Contamination: The Kiss of Death for a Real Estate Deal?' (2003) 5(1) Environmental Practice 6.

[37] B Greenwood, 'The environmental transaction' (1996) JPEL 11.

[38] There is a lot of literature discussing Part IIA's cases: V Fogleman, 'Circular Facilities (London) Ltd v. Sevenoaks District Council: the meaning of "knowingly permitted" under the contaminated land regime' [2005] Oct JPL 1269; M Zuckerman, 'Too Hot to handle?' (2006) 156 NLJ 1708; M Edwards, 'S78F of the EPA 1990 – appropriate person – statutory successor' [2007] JPL 1737; R Carriage and O Ennis, 'Environmental Protection Act 1990 Part 2A: where does the National Grid Gas case leave practitioners?' (2007) Nov JPL 1557; J Thornton, 'Case Comment: Contaminated land' (2008) 20(2) JEL 293; J Thornton, 'Contaminated Land – Case law Update' (Brownfield Briefing Conference, 22

Ltd) v Secretary of State for Environment, Food & Rural Affairs [2010] EWHC 561 (admin),[39] Samuels notes that it provides, 'A vivid illustration of the potential consequences of buying or owning contaminated land.'[40] Although there is a lack of case law for contaminated land liability, there has nevertheless been an increased 'Europeanisation'[41] of contaminated land policy over the last couple of years. This 'Europeanisation' is a direct consequence of the Environmental Liability Directive's[42] implementation into the various laws of EU Member States.[43]

The literature on Part IIA of the EPA 1990 shows that it has presented, and presents, no real threat for banks. It suggests that the reason for this is because the Part IIA regime is under-resourced and inefficiently applied by the regulators in practice.[44] However, there is presently a gap in the literature surrounding this area of study. This gap has emerged because of the absence of empirical work. This research aims to fill this gap

January 2008) <http://www.39essex.co.uk/docs/articles/JTH_Contaminated_Land_220108.pdf> accessed 6 October 2014; J Thornton, 'Contaminated land: the latest developments' (2009) JPL 8; A Wiseman, 'Sandridge Contaminated Land Appeal' (2009) 20(4) WL 207; D Hart, J Jolliffee and R Marcus, 'Contaminated land in Corby and Sandridge: historic liabilities: Part 2: Sandridge' (2009) 17(4) Env Liability 129; R Fairley, 'Clean-up legislation' (2010) 10 Env 113; N Rose, 'Contaminated Land: Sandridge Case' (2010) 21(3) PLC 74; 'Case Comment: Contaminated Land – appeal against apportionment' (2010) Mar Env L M 2; and C May, 'An insidious problem' (2010) 1012 EG 88 <http://search.ebscohost.com/login.aspx?direct=true&db=buh&AN-50221075&site=ehost-live> accessed 6 September 2013.

[39] This case is outlined in more detail in ch 3, pg 106.

[40] A Samuels, 'A review of the law and practice on contaminated land' (2012) 12 JPL 1459.

[41] A Layard, 'The Europeanisation of Contaminated Land' (2004) 6(6) Env L Rev 97. See also, N Atkinson, 'A Legal Regime for the Clean Up of Contaminated Land: Lessons from Europe' (1995) 4(5) European Environmental Law Review 141; R. Seerden and K. Deketelaere, *Legal Aspects of Soil Pollution and Decontamination in the EU Member States and the United States* (Antwerp, Intersentia 2000); and Vaughan, 'Policy, Practice and Pollution' (n 19) 17.

[42] Directive 2004/35/EC of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage.

[43] V Fogleman, 'The Environmental Directive and its impact on English environmental law' (2006) JPL 1443. See also, R Lee, 'EU proposals on environmental liability: from a private to public framework' (2003) Mar JBL 180; G Winter, JH Jans, R Macrory and L Krämer, 'Weighing up the EC Environmental Liability Directive' (2008) 20(2) JEL 163; D Lawrence, 'The new environmental liability regime: not only the polluter will pay' (2009) 25(4) PN 162; and Lee, 'New Environmental Liabilities' (n 29) 264.

[44] Vaughan, 'The contaminated land regime: still suitable for use?' (n 33) 142.

by using the interview data to show the lenders' present perceptions of Part IIA.[45]

B. Bank Lending and the Environment

Another knowledge gap in the literature concerns bank lending and the environment. Like Part IIA, the writings in this area lack empirical research. The older academic literature on banks and environmental risks tends to focus heavily upon the threat posed to lenders by direct lender liability. In, 'the quest for the environmental equilibrium',[46] the regulation of the environment has increased over the last twenty-five years.[47] Increased regulation in the 1990s and 2000s, initially drove environmental due diligence in commercial bank lending. For some, the development of environmental law was quite unexpected.

> 'If, say, in 1990, someone had said to me that, in a few short years, I would be writing a text on environmental risk, I'm sure that I would have laughed out loud.'[48]

As a result of the growth of environmental regulation, many environmental law practitioners and academics have questioned why banks should face liability and risks because of the environmental harm that is caused by their borrowers.[49] In some

[45] infra, chs 5, 6 and 7.
[46] A Waite, 'The quest for environmental equilibrium' (2005) 7 *Env L Rev* 35.
[47] It is noteworthy that since 2008 there have been a number of 'major reforms' to environmental regulation under the government's 'red tape challenge'. See, Defra, *Better Regulation* (n 6).
[48] P Case, *Environmental risk management and corporate lending – a global perspective* (Woodhead Publishing, Cambridge 1999) ix.
[49] See, for example, M Redman, 'Environmental Law for Bankers and Insolvency Practitioners' (1993) 8(3) JIBL 85; M Fordham, 'A Rude Awakening' (1993) 143 NLJ 50; P Davies, 'Lender Liability: what happens now?' (1995) 14(2) IBFL 16; R Pitchford, 'How Liable Should The Lender Be? The Case Of Judgment-Proof Firms And Environmental Risk' (1995) 85(5) The American Economic Review 1171; JH Marks, 'The Environmental Liability for Lenders in England: Is the Tide Coming In?' (2001) 27 NCJ

respects, the allocation of lender liability to a bank for a commercial borrower's environmental pollution is contrary to the *polluter pays principle*,[50] which suggests that the polluter is primarily responsible for any damage that it has caused. The issues surrounding lender liability for environmental harm are well portrayed by Jarvis and Fordham:

> 'Why should "lender liability" develop? Banks do not pollute rivers. Why should they be responsible for the activities of their borrowers? If someone buys a car and kills a pedestrian the bank which provided the loan is not held responsible.
>
> Should it be enough, then, that the lender could have prevented the pollution, by refusing to lend or by supervising the activities of its borrower? What if the lender knew about the polluting process, or act? What if the loan office was a member of the borrower's board, or the loan terms allowed it to authorise the borrower's dealings or to collect the debts?'[51]

Hooley goes on to suggest that the reason why lenders should be responsible for the activities of their borrowers is because:

> 'Lenders provide the funds that enable the polluting activity to continue and may have made considerable profits from that activity. Lenders have "deep

Int'l L & Com Reg 1; and M Jeucken, *Sustainable Finance and Banking: the Financial Sector and the Future of the Planet* (Earthscan, London 2001).

[50] Principle 16 of the Rio Declaration on Environment and Development.

[51] J Jarvis and M Fordham, *Lender Liability: environmental risk and debt* (1st edn, Cameron May 1993) 2.

> pockets" and are able to meet clean-up costs. Lenders are in a good position to investigate and require environmental compliance from their borrowers. Political and economic considerations are at work here just as much as legal ones.'[52]

Therefore, in response to Jarvis and Fordham's questions, lender liability for environmental damage should be viewed as wholly different from the situation where a bank lends money to a borrower who kills a pedestrian in a road traffic accident (as above), as that is a situation which resides outside of the bank's responsibility as a mere financier. However, lenders do have an increasing responsibility to protect the environment, as suggested by Hooley.[53] By making sustainable, social and ethical investment choices, banks can reduce the environmental impact and harm that their borrowers create by requiring their customers to meet defined standards as a condition that is contingent to the grant and maintenance of monetary funding.

Literature has described the banks' risk management practices as now being 'green' in their outlook.[54] The lenders' role in the protection of the environment is so important

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[52] R Hooley, 'Lender liability for environmental damage' (2001) CLJUK 405.

[53] See, BJ Richardson, 'Ethical finance in Britain: a neglected prerequisite for sustainability' (2003) 5 Env L Rev 109; D Sarokin and J Schulkin, 'Environmental concerns and the business of banking' (1991) 74(5) Journal of Commercial Bank Lending 6; PN Grabosky, 'Green markets: environmental regulation by the private sector' (1994) 16(4) Law & Policy 419; GL Clark and T Hebb, 'Why should they care? The role of institutional investors in the market for corporate global responsibility' (2005) 37(11) Environment and Planning 2015; B Scholtens, 'Corporate Social Responsibility in the International Banking Industry' (2009) 86(2) Journal of Business Ethics 159; BJ Richardson, 'Keeping Ethical Investment Ethical: Regulatory Issues for Investing for Sustainability' (2009) 87(4) Journal of Business Ethics 555; and DA Lubin and DC Esty, 'The Sustainable Imperative' (2010) 88(5) Harvard Business Review.

[54] For literature on the 'greening' of bank lending, see: JJ Bouma, M Jeucken and L Klinkers (eds), *Sustainable Banking: the greening of finance* (Greenleaf Publishing 2001); F Studemann, '"Green" Bank Puts Principles First' (1993) 48(8) Int Management 32; B Harvey, 'Ethical Banking: the case of the Co-op bank' (1995) 14(2) Journal of Business Ethics 1005; Greenwood (n 37) 11; BJ Richardson, 'Environmental liability and banks: recent European developments' (2002) JIBL 287; R Kerry Turner, J Powell and A Craighill, 'Green Taxes, Waste Management and Political Economy' (2003) CSERGE Working Paper WM 96-03 <http://www.cserge.ac.uk/sites/default/files/wm_1996_03.pdf> accessed 6 October 2014; S Hadfield-

in the modern age of corporate financing that Richardson has suggested that the banks' ability to make financial choices that are both ethical and sustainable is, 'a neglected prerequisite for sustainability'.[55] Egede and Lee believe that bank lending and the environment are, 'inevitably inter-related.'[56] Richardson agrees with this, supporting the argument that financial institutions play a key role in achieving sustainability.[57] The typology of sustainable and responsible financing has been outlined by Bouma and Jeucken,[58] who suggest that the majority of financial institutions will evolve through a number of stages before their financing eventually becomes 'green' in its outlook.[59] Within this typology, banks begin with a 'defensive' style of lending, and gradually become more sustainable as a result of growing market and societal pressures.[60] In agreement with Bouma and Jeucken, Thompson and Cowton propose that, 'In recent years, it has come to be recognised that banks' lending operations affect, and are affected by, the state of the natural environment.'[61] Indeed, the paradigmatic 'greening' of banking risk management practices means that it is now increasingly difficult to ignore the impact that the environmental law has had on the economy, and the institutions that form a part of the economic structure.

Hill, 'The Greening of Project Finance' (2008) Geography Compass 1058; and, T Papadopoulos, 'The "Greening" of Project Finance: Is this a viable project?' (2009) 7(1) The Icfai University Journal of Banking Law 8.

[55] Richardson, 'Ethical finance in Britain' (n 53) 109.

[56] T Egede and R Lee, 'Bank lending and the environment: not liability but responsibility' (2007) Nov JBL 868.

[57] Richardson, 'Ethical finance in Britain' (n 53) 109.

[58] JJ Bouma and M Jeucken, 'The Changing Environment of Banks' in JJ Bouma, M Jeucken and L Klinkers (eds), *Sustainable Banking: the greening of finance* (Greenleaf Publishing 2001) 26-29.

[59] ibid.

[60] ibid.

[61] P Thompson and CJ Cowton, 'Bringing the environment into bank lending: implications for environmental reporting' (2004) 36(2) The British Accounting Review 197. See also, P Thompson and CJ Cowton, 'Do Codes Make a Difference? The Case of Bank Lending and the Environment' (2000) 24 (2) Journal of Business Ethics 165; and P Thompson, 'Assessing the environmental risk exposure of UK banks' (1998) 16(3) International Journal of Bank Marketing 129; and Hadfield-Hill (n 54) 1058.

What has caused this 'greening of finance'[62] to occur? The older literature suggests that the direct lender liability threat from environmental legislation, in the USA, initially drove the banks to introduce environmental due diligence into their risk management frameworks.[63] Marks states that:

> 'During the last two decades of the twentieth century, the ebb and flow of legislative and judicial activity in the United States has raised important issues regarding the potential exposure of lenders to environmental liability.'[64]

More specifically, the writings pin-point the origins of lender liability for environmental harm to the enactment of the United States of America's Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) 1980.[65] The enactment of the CERCLA regime led to a time of great uncertainty for many US bank lenders.[66]

> 'Uncertainties and confusion pervade environmental liability standards under the Comprehensive Environmental Response, Compensation and

[62] Bouma et al. (n 54).
[63] Hooley (n 52) 416. Other literature which discusses the 'American experience' of lender liability and environmental risk, includes: Jarvis and Fordham (n 51); J O'Donovan, *Lender Liability* (Sweet & Maxwell 2005); M Townsend, 'Risky Business? Assessing the Lender's Real Environmental Risk and How to avoid it?' (2006) 11 JIBFL 483.
[64] Marks (n 49) 1. See also, Fordham, 'A Rude Awakening' (n 49) 50.
[65] See, 'Notes: Cleaning Up the Debris after Fleet Factors: Lender Liability and CERCLA's Security Interest Exemption' (1990) 104 Harvard Law Review 1249. See also, AK Obermann and R Arnold, 'Environmental Regulation – EPA Proposed Rule Clarifying Lender Liability' (1991) 9 JIBL 371; and MH Ahrens and DS Langer, 'Lender Liability under CERCLA - Environmental risks for Lenders under SUPERFUND: A Refresher for the economic downturn' (2008) 3 Bloomberg Corporate Law Journal 482–493.
[66] infra, ch 2, pp 63-75.

> Liability Act of 1980 (CERCLA). As a result, lending practices have become distorted.'[67]

Roulac's study, which was undertaken in America in 1993, provides empirical evidence to suggest that due diligence within real estate transactions became, 'a necessary precondition', because of CERCLA.[68] During the 1990s, UK banks became concerned about the direct lender liability, which had occurred in America.[69] Redman, for instance, states that, 'Banks and insolvency practitioners are becoming increasingly aware of the implications of environmental law on their businesses.'[70] In response to CERCLA, literature developed in the UK showing how direct lender liability for environmental risks was inevitably going to arise (see below). Practitioners attempted to demonstrate how liability may emerge for a bank that did not exercise the appropriate level of environmental due diligence[71] within its risk management framework.[72]

> 'Against this background lenders are well advised to make themselves fully aware of the environmental factors relating to properties or assets over

[67] MI Greenberg and DM Shaw, 'To Lend Or Not To Lend – That Should Not Be The Question: The Uncertainties Of Lender Liability Under CERCLA' (1992) 41(5) Duke Law Journal 1211.
[68] SE Roulac, 'Environmental Due Diligence, Information Requirements and Decision Criteria' (1993) 8(1) The Journal of Real Estate Research 139.
[69] For a good article on environmental risk in Canada see, MH Ogilvie, 'Enter At Your Own Risk: Environmental Lender Liability In Canada' (1996) Jan JBL 94.
[70] Redman (n 49) 85. For an overview of the CERCLA regime refer to ch 2, pg 63.
[71] For literature outlining environmental risk and due diligence in banking, see, S Tromans, 'The relevance of environmental law for banks' (1990) 5(11) JIBL 433; W Blair, *Banks, Liability and Risk* (3rd edn, Informa Law 2001); and P Hood and J Virgo ed, *Principles of Lender Liability* (OUP 2012). Earlier work may also be found on this topic from the literature that was published in the United States during the 1980s and 1990s.
[72] See, amongst others, BF Elliot and EF Mannino, 'Lender Liability: an emerging threat' (1990) April IBFL 149; P Long and J Rhoades, 'Is the environmental holiday over for English lenders?' (1993) July International Financial Law Review 33; T Parker and E Welch, 'A bank's view of lender liability in environmental legislation' (1993) 8(6) JIBL 217; C Keegan, 'United States: uncertainty for lenders' liability for environment' (1995) 13(11) IBFL 111; and C Stoakes, 'The loans that come back to haunt' (1997) 335 *Euromoney* 34.

> which they propose to take charges.'[73]

A good account of the early concerns surrounding environmental risk and bank lending in the UK is given in Jarvis and Fordham's book, *Lender Liability: Environmental Risk and Debt* (1993).[74] Jarvis and Fordham offer one of the most important accounts of writing on bank lending and the environment for this thesis. They provide an early 1990s perspective on lender liability for environmental issues (i.e. before the introduction of Part IIA of the EPA). Chapter 2 begins by making 'A Trans-Atlantic Glance' at the banks' experiences of lender liability for environmental issues in America.[75] This Chapter then leads on to 'A Cross-Channel Glance' in Chapter 3. [76] The rest of the book outlines the national sources of law that are available for creating lender liability, as well as an insight into key terms and triggers of liability, and safe lending practices. In relation to the national sources of environmental legislation, Jarvis and Fordham comment:

> 'It is obvious that in order to address the question of lender liability for environmental harm in the UK one must start with a grasp of the parameters and principles of domestic environmental liability.'[77]

The excerpt above explains why it is necessary for this thesis to outline the UK law relating to land pollution in Chapters 2, 3 and 4. Placing the book into the historical context of the time, Jarvis and Fordham display the early fears of lender liability for environmental risk and debt. Chapters 1, 2 and 3 of Jarvis and Fordham's book were

[73] J Walters, 'Lenders and the Environment' (1991) 135(9) Solicitors' Journal 274, 275.
[74] Jarvis and Fordham (n 51).
[75] ibid 10.
[76] ibid 24.
[77] ibid 33.

designed to build upon this fear. They place significant emphasis on the likelihood and severity of the threat of direct lender liability. However, as there are now other environmental risks to consider (see below), this source is outdated, and does not reflect the lenders' present perceptions of environmental liability and risk.

The literature shows that, in the 1990s and early 2000s, there remained a primary focus on lenders' primary environmental liability, and the use of risk reduction techniques.[78]

> 'The risk of environmental liability must be taken seriously by commercial lenders and their advisers.'[79]

In hindsight, however, the literature on lender liability for environmental risk from this time can now be viewed as a scare-mongering tactic, used by practitioners to 'fish for work'. This attitude is reflected in the titles of some of the journal articles that were published, e.g. 'Environmental liability: a gun at the lender's head?'[80] or 'Pollution liability – a financier's nightmare?'.[81] As well as direct risk, some of the early writings discuss the indirect environmental risks (i.e. credit and security risks) that banks may incur during their loan financing.[82]

> 'There are two main areas of risk for banks: a) The risk that the bank will not be repaid because the borrower's assets are substantially depleted by environmental clean-up or other related costs. b) The risk that the bank

[78] See, for instance, Blair (n 71) ch 5; and Townsend (n 63) 483.
[79] Hooley (n 52) 405.
[80] J Fordyce, J Kofman and D Tay, 'Environmental liability: a gun at the lender's head?' (1990) May International Financial Law Review 19.
[81] 'Pollution liability – a financier's nightmare?' (1990) July Newbuildings 4.
[82] Tromans (n 71) 434.

itself may be held liable for environmental clean-up or other related costs.'[83]

Over the last seven or eight years, a change has occurred in the literature on lender liability and environmental risk. The more recent works on this topic show that, nowadays, the focus has shifted from the 'traditional environmental risks' that pose a threat to banks (i.e. direct liability and indirect risks) to a sudden inclusion of the reputational risk that banks can incur while lending to a polluting borrower, or project.[84] Egede and Lee present a contemporary exhibition of bank lending and environmental risk,[85] as follows:

- Direct lender liability;
- Credit risk;
- Security risk;
- Insolvency; and
- Project risk.[86]

This presentation of risk is wholly different to Jarvis and Fordham's book, and shows how perceptions have changed towards environmental risk over time. Contrary to the

[83] R Griffith, 'New liabilities for the banker in England' (1993) 4 IBLJ 435.
[84] Egede and Lee (n 56) 868.
[85] ibid.
[86] ibid.

older works, today, direct lender liability is viewed as the least likely risk to materialise in commercial lending practices.[87] Egede and Lee believe that, 'This is a remote prospect both under the UK and European law.'[88] In response to the old perception concerning environmental lender liability, they propose that:

> 'For the last ten years, those involved in corporate finance have been more concerned about environmental costs and liabilities. But there has been a feeling that these would arrive with some big bang, and the fact that this has not happened has given way, at times, to complacency.'[89]

Egede and Lee's observation suggests that direct lender liability is not the sole driver for the lenders' use of environmental due diligence.[90] Now the literature emphasises how the banks' fear of gaining a bad reputation, by way of being associated with environmentally damaging clients, is increasingly becoming the main driving force for the conduct of environmental due diligence in banks.[91] In a paper on the Equator Principles (EP), and social rights, Clayton advises that:

> 'The rights affected in domestic banking tend to be of a micro nature in that only one person or organisation is affected. In the arena of international banking, the social rights that are affected are of a macro nature affecting many thousands of individuals.'[92]

[87] ibid.
[88] ibid 875.
[89] ibid 868.
[90] ibid 875.
[91] ibid 880-883.
[92] N Clayton, 'Equator Principles and Social Rights: incomplete protection in a self-regulatory world' (2009) 11(3) Env L Rev 173. For other literature on the Equator Principles, read, PQ Watchman, A

The threats presented in project finance truly provide support to the argument which suggests that there has been an increased focus on environmental, social and ethical risk management in financial institutions.[93] It also shows how non-financial risks in banking have undergone an increased 'globalisation' over the last couple of years.[94] The EP are further explored in Chapter 7.[95]

There is a small amount of literature concerning environmental insurance as a means of managing and mitigating the environmental risks that may occur during lenders' corporate transactions. The literature shows that specific environmental insurance policies initially formed in America,[96] but the use of environmental insurance has also become a feature within the UK's financial market.[97] Sykes, in a paper on the use of environmental insurance in the UK, states that the intervention of insurance in transactions between vendors, purchasers and lenders of environmentally suspect land can be viewed as a solution of risk reduction.[98] Data in Chapter 4 provide a

Delfino and J Addison, 'EP 2: the revised Equator Principles: why hard-nosed bankers are facing soft law principles' (2007) 1(85) Law & Fin Mkt Rev 85; B Scholtens and L Dam, 'Banking on the Equator. Are Banks that Adopted the Equator Principles Different from Non-adopters?' (2007) 35(8) World Development 1307; A Hardenbrook, 'The Equator Principles: The Private Sector's Attempt at Environmental Responsibility' (2007) 40(1) Vanderbilt Journal of Transitional Law 197; C Wright and A Rwabizambuga, 'Institutional Pressures, Corporate Reputation, and Voluntary Codes of Conduct' (2006) 111(1) Business and Society Review 89-117; OF Amalric, 'The Equator Principles: A Step Towards Sustainability?' (2005) Center for Corporate Responsibility and Sustainability Working Paper No 01/05 <http://www.nachhaltigkeit.info/media/1317385761phpOHcawW.pdf> accessed 6 October 2014.; BJ Richardson, 'The Equator Principles: The Voluntary Approach to Environmentally Sustainable Finance' (2005) 14(11) European Energy and Environmental Law Review 280; and JM Conley and CA Williams, 'Global Banks as Global Sustainability Regulators?: The Equator Principles' (2011) 33(4) Law and Policy 542.

[93] Egede and Lee (n 56) 880.

[94] AE Boyle, 'Globalising Environmental Liabilty: The Interplay of National and International Law' (2005) 17 JEL 1.

[95] infra, ch 7, pg 313.

[96] R Rodger, 'Pollution – Construction of an insurance policy' [1995] 12 Int ILR 253; MF Doling, 'An Overview of the Exxon Valdez Insurance Cover Dispute' [1997] 10 Int ILR 313; and DL Elkind, 'Insurance Coverage for Asbestos Claims Against Foreign Corporations' [1997] 10 Int ILR 310

[97] S Sykes, 'Environmental insurance solutions as a means of facilitating transactions involving contaminated land and environmentally suspect land' (1999) Mar Env L Rev 27, 35. See also, Redman (n 49) 85; J Lipton, 'Insurance for Environmental Liability: Some Policy Issues' (1998) 6(6) Int ILR 188; and VA Jenkins, 'Environmental Impairment Liability in Europe' (1999) July JBL 378.

[98] Sykes, 'Environmental insurance solutions' (n 97) 35.

contemporary perspective of environmental insurance's effectiveness as a tool for reducing risk.

III. Why is the research necessary now? Challenges to Contaminated Land Policy

In 1998, the Labour Government introduced a sixty per cent 'national target' for new house building to take place on brownfield land.[99] From 1995-2010, 36,680 ha of brownfield land was redeveloped.[100] Without a 'brownfield first approach',[101] it is estimated that, 'an area of countryside at least seven times the size of Southampton (Southampton City Council's area is 19 square miles) would have been lost to housing.'[102] However, because of the economic downturn, the current Government has introduced extensive budget cuts to save money. Considering the current age of austerity, this section assesses why the research is necessary by analysing the reductions in government funding for encouraging contaminated land clean-up. It argues that the recent changes will not only impede the effort to remediate contaminated land but will also have a detrimental effect upon greenfield land, private sector investment in the brownfield, and the micro-economics of some of the most deprived parts of the UK.

Identifying the challenges currently facing contaminated land policy is necessary for answering the overarching research question and sub-question 1. This section of the

[99] Lawrence and Lee, 'Permitting Uncertainty' (n 31) 261. See also, Department for the Environment, Transport and the Regions, *Planning for the Communities of the Future: A White Paper* (DETR 1998).
[100] Campaign to Protect Rural England, 'Building in a small island? Why we still need a brownfield first approach' (Green Balance, Nov 2011) 5. <file:///C:/Users/Lloyd/Downloads/Building_in_a_small_island.pdf> accessed 20 August 2014.
[101] ibid.
[102] ibid.

chapter links to the research question and sub-question by demonstrating how contaminated land redevelopment has been significantly weakened by the Coalition Government's policies in a period of austerity. Thus, it provides an explanation for why the banks' perceptions of the environmental risks have changed, and expresses how other things must now be driving environmental due diligence in lending institutions.

A. Cabernet's A-B-C Model, and Incentives for Land Redevelopment

After Lehman's collapse, in 2008, the world has witnessed one of the worst global economic depressions since the Wall Street Crash of 1929.[103] In the UK, the government has, in many ways, made land redevelopment economically unviable due to legal reform, and reduced financial support for driving clean-up activities. In order for intervention to take place on some of the more problematic sites, economic incentives are needed to 'break the blight', and encourage the development of Public Private Partnerships (PPPs).[104] Savini et al. suggest that large-scale development projects are often driven by a 'supply-oriented attitude'.[105] They further state that, because of the economic downturn, an 'investment dilemma' has occurred.[106] As noted above, there has been a declining trend in the availability of public sector funding for contaminated land identification and remediation.[107] If the private sector also fails to

[103] C Irvine, 'Lehman Brother collapse: How it compares with recent history' *Daily Telegraph* (London, 15 September 2008) <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/2964405/Lehman-Brothers-collapse-How-it-compares-with-recent-history.html> accessed 2 December 2013.
[104] 'What are Public Private Partnerships?' (*BBC News*, 12 February 2003) <http://news.bbc.co.uk/1/hi/uk/1518523.stm> accessed 14 August 2014.
[105] F Savini, W Salet and S Majoor, 'Dilemmas of planning: Intervention, regulation, and investment' (2014) Planning Theory 1, 11 – 12.
[106] ibid 12.
[107] M Perella, 'Funding cuts could seriously harm contaminated land clean-up efforts' (*edieWaste*, 14 July 2011) <http://www.edie.net/news/5/Funding-cuts-could-seriously-harm-contaminated-land-clean-up-efforts/20390/> accessed 2 December 2013. See also, S Spear, 'Contaminated land cuts not assessed' (*Environmental Health News*, 22 January 2014) <http://www.ehn-online.com/news/article.aspx?id=10714> accessed 14 August 2014. For cuts to other environmental

engage in land redevelopment projects because of the inherent risks that are accredited to such sites, then it would seem that England's contaminated land heritage will remain wholly intact for some time to come. The primary problem with trying to encourage the remediation of contaminated land is that such land can become an unprofitable project for developers. [108]

The Concerted Action on Brownfield and Economic Regeneration Network (Cabernet) has created a conceptual model to portray the economic viability of different redevelopment projects. In the model, economic viability is measured by the profit made from the land value after reclamation costs have been paid. The Network describes the model as the A-B-C model; [109] it is used to categorise brownfield sites. Under the model, "A" sites are labelled as *'Self-developing Sites'*.[110] They are described as 'self-developing' because such sites have very little remediation requirements, and are therefore the most profitable to develop.[111] The private sector supplies the primary source of funding for "A" sites, as a result of their economic viability potential.[112] "B" sites are called *'Potential Development Sites'*,[113] because, while they may not be as profitable as "A" sites, there is still a good margin for developers to make a little profit,

areas, see, D Carrington, 'Hundreds of flood defence schemes unbuilt due to budget cuts' *The Guardian* (14 July 2012) <http://www.theguardian.com/environment/2012/jul/14/flood-defence-schemes-unbuilt accessed 14 August 2014> accessed 14 August 2014; R Edwards, 'Air pollution monitoring stations face closure as government looks to cut costs' *The Guardian* (London, 22 August 2013) <http://www.theguardian.com/environment/2013/aug/22/air-pollution-monitoring-stations-shut> accessed 14 August 2014; and, 'MPs concerned over environmental budget cuts' (*BBC News*, 7 January 2014) <http://www.bbc.co.uk/news/science-environment-25623157> accessed 14 August 2014.

[108] BJ Richardson, 'Economic Instruments in EU Environmental Law Reform: Is the UK Government "Sending the Right Signals"' (2002) 3 European Journal of Law Reform 427, 437. See also, J Steele, 'Remedies and Remediation: Foundational Issues in Environmental Liability' (1995) 58 (5) Mod L Rev 1.

[109] U Ferber et al., 'Sustainable Brownfield Regeneration: CABERNET Network Report' (University of Nottingham, 2006) 43 <www.cabernet.org.uk/resourcefs/427.pdf> accessed on 2 December 2013.

[110] ibid 44.

[111] ibid.

[112] ibid.

[113] ibid.

or break even, from the land value.[114] Cabernet suggests that these sites are usually funded through public-private co-operation.[115] Finally, "C" sites are described as *'Reserve Sites'*, and projects taken on within these sites will normally lead to the developer making a loss.[116] Therefore, it is of no surprise that private sector developers usually tend to avoid investing in "C" sites. The presence of "C" sites helps to explain how property blight occurs. Cabernet says that it is usually in "C" sites that economic incentives are most widely used.[117] The public sector tries to draw in private interest with economic incentives in order to regenerate the more onerous "C" sites. What is problematic in trying to promote the development of "C" sites is that they are extremely undesirable to developers and investors, alike. Their undesirability comes from the financial loss that could be suffered if the remediation costs are more than the land value when the project is completed. This is why public sector support is essential for land redevelopment.

After looking at Cabernet's conceptual model, it is clear why developers need to be attracted to brownfield land redevelopment through economic incentives, etc. In a paper concerning the development and use of fiscal incentives for brownfield land remediation, Thornton et al. stipulate that:

> 'Brownfields are often not economically competitive for regeneration compared with Greenfield sites without public intervention. The economic,

[114] ibid.
[115] ibid.
[116] ibid.
[117] ibid.

> environmental and social barriers present at the site frequently hinder returning brownfields to beneficial use.'[118]

They go on to outline the three primary incentives for encouraging brownfield land clean-up across Europe (i.e. 'direct funding', 'indirect funding' and 'legal incentives').[119] The two primary economic clean-up methods assessed by this research are: (1) government funding; and, (2) taxation. It is important to discuss the recent decline in these two types of economic incentives, because it clearly shows why the research is necessary now.

B. Government Funding and Restructuring

Research into the redevelopment of contaminated land for housing use found that, 'There was a widespread belief amongst the general public, financial institutions, developers and estate agents that government should take the lead in securing the re-use of contaminated land.'[120] Thus, reduced Government support for contaminated land clean-up will inevitably lead to fewer determinations under Part IIA, and an increased work-load for the planning system.[121] Since 2008, there has been a significant emphasis on 'localism', and the decentralisation of power into the hands of local communities.[122] Consequently, changes have been made to England's planning policy guidance (where the old PPGs and PPSs were replaced by a consolidated planning policy framework:

[118] G Thornton et al., 'The challenge of sustainability: incentives for brownfield regeneration in Europe' (2007) 10(2) Environmental Science and Policy 116.
[119] ibid 118.
[120] Syms (n 14) 225.
[121] A James, 'Are changes in DEFRA funding impacting on planning applications?' (*Envirep.co.uk*, no date) <http://esinternational.com/news/defra-funding-impact-planning-applications/> accessed 14 August 2014.
[122] Lowndes and Pratchett (n 5) 21.

the NPPF),[123] the contaminated land regime, and the funding of regional government,[124] etc. While on the surface these changes may appear to be a devolution of power, and a means to reduce bureaucratic decision-making, [125] upon closer inspection the move from regionalism to localism has not proved beneficial for contaminated land redevelopment policy.[126] This is so because there is now less funding for contaminated land investigation.

1. Cutting Government Funding

Government funding for contaminated land remediation is available at both national and European levels.[127] At the national level, government subsidy comes from a number of sources, while at the European level Member States can request backing for contaminated land clean-up from the EU Structural Funds.[128] One of the main funding programmes for local authorities in identifying and remediating contaminated land was the EA's Contaminated Land Capital Projects (CLCP) Programme (also known as 'the Capital Grants Scheme').[129] The Programme helped local authorities to 'cover capital costs'[130] related to contaminated land clean-up, and fulfil their statutory duties under

[123] infra, ch 2, pg 122.
[124] See, Department for Communities and Local Government, *Localism Bill: abolition of the regional planning tier and introduction of the Duty to Cooperate: Impact assessment* (DCLG, January 2011) 8 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/6046/1829659.pdf> accessed 14 August 2014.
[125] O Dutton, 'The practical implications of the Localism Act 2011' (*Local Government Lawyer*, 9 January 2013) <http://www.localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=12753%3Athe-practical-implications-of-the-localism-act-2011&catid=59%3Agovernance-a-risk-articles&Itemid=27> accessed 14 August 2014.
[126] 'The Localism Act – Two Years On' (*Local Government Lawyer*, December 2013) <http://www.localgovernmentlawyer.co.uk/images/Localism%20Act%20Survey.pdf> accessed 14 August 2014.
[127] Thornton et al., 'The challenge of sustainability' (n 118) 118.
[128] ibid.
[129] Environment Agency, 'Contaminated Land Capital Programme' (EA, no date) <http://webarchive.nationalarchives.gov.uk/20140328084622/http://www.environment-agency.gov.uk/research/planning/121220.aspx> accessed 14 August 2014.
[130] ibid.

Part IIA.[131] Welsh CLCP was abolished in 2010.[132] After being cut from £19.9 million to £4.35 million in 2011,[133] on 1 April 2014, England's CLCP was closed,[134] and a contingency fund of £500,000 made available for local authorities to bid upon for a period of three years.[135] CLCP will cease to exist in England from 1 April 2017.[136] Without the Programme, fewer determinations will now be made under the contaminated land regime.[137] Again, this is because of the cuts that have been made to the funding for identifying and remediating contaminated land.

2. Cutting Regional Development

Many of the regional mechanisms (e.g. regional assemblies/leadership boards, regional spatial strategies (RSSs), and the regional development agencies (RDAs)) that were set up to encourage brownfield development under Labour have now been abolished in the move towards localism.[138] A brief account of the impact that the abolition of the RDAs will have to sustainable development is provided in this section.

The Regional Development Agencies Act 1998[139] was brought into force to allow the creation of England's nine Development Agencies.[140] In total, eight RDAs began

[131] ibid.
[132] 'Local Authority Contaminated Land Capital Funding Slashed' (*Whitemoss Environmental Solutions*, 3 May 2011) http://www.whitemosstreatment.co.uk/blog/?p=48 accessed 14 August 2014.
[133] ibid.
[134] Environment Agency 'Contaminated Land Capital Programme' (n 129).
[135] ibid.
[136] ibid.
[137] S Spear, 'Contaminated land regime axed' (*Environmental Health News*, 11 December 2013) <http://www.ehn-online.com/news/article.aspx?id=10566> accessed 14 August 2014.
[138] M Sandford, 'The abolition of regional government' (SN/PC/05842, 27 March 2013) 4-7 <file:///C:/Users/Lloyd/Downloads/SN05842.pdf> accessed 14 August 2014.
[139] Regional Development Agencies Act (RDAA) 1998 (now repealed).
[140] Department for Business, Innovation and Skills, *Closing the RDAs: Lessons from the RDA Transition and Closure Programme* (BIS, July 2012) 12 <http://webarchive.nationalarchives.gov.uk/20121212135622/http://bis.gov.uk/assets/biscore/economic-development/docs/c/12-986-closing-rdas-lessons-from-transition-and-closure-programme.pdf> accessed 20 August 2014.

functioning on 1 April 1999.[141] The London Development Agency (LDA) started operating later in July 2000.[142] The underlying purposes of the Development Agencies were highlighted in section 4 of the Regional Development Agencies Act 1998 (now repealed). In relation to brownfield clean-up, the RDAs two most important duties were:

Section 4(1)(a):

> 'to further the economic development and the regeneration of its area.'[143]

And, section 4(1)(e):

> 'to contribute to the achievement of sustainable development in the United Kingdom where it is relevant in its area to do so.'[144]

Thus, the RDAs were pivotal for generating sustainable development in their regional districts. However, on 31 March 2012, the RDAs were abolished under section 30 of the Public Bodies Act 2011.[145] Section 191 of the Localism Act 2012 wound up the LDA.[146] The RDAs and LDA have now been replaced by Local Enterprise Partnerships (LEPs).[147] LEPs are said to only partially endorse some of the objectives that were

[141] ibid.
[142] ibid.
[143] RDAA 1998, s 4(1)(a).
[144] ibid, s 4(1)(e).
[145] Public Bodies Act 2011, s 30.
[146] Localism Act 2012, s 191.
[147] Her Majesty's Government, 'Local Government: realising every place's potential' (HM Government, 28 October 2010) 39 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32076/cm7961-local-growth-white-paper.pdf> accessed 20 August 2014.

found in Part 1 of the 1998 Act, [148] and have been described as a form of 're-centralisation in disguise'.[149] The effectiveness of the LEPs in driving redevelopment projects is yet uncertain. What is apparent, however, is that the revocation of the Development Agencies has had a significant impact on the micro-economies of the English regions, and represents a huge blow for sustainable development in England. *PriceWaterhouseCoopers* undertook a study of the economic benefits that the RDAs and the LDA generated. The study held that, 'every £1 of RDA spend will add £4.50 to regional GVA [gross value added].'[150] Without this support, many of the most blighted regions will now lose the necessary economic funding that they desperately need in a period of austerity.

C. Taxation

Green taxation is 'rapidly evolving' as a global trend.[151] However, as with government funding, the different forms of tax relief that were/are available for the redevelopers of land affected by contamination have been affected by the government's cost-cutting agenda. Without some of the previous tax reliefs, it will no longer be financially viable

[148] G Bentley, D Bailey and J Shutt, 'From RDA to LEP: A New Localism? Case Examples of West Midlands and Yorkshire' (2010) 25 Local Economy 535.
[149] ibid.
[150] Department for Business, Enterprise and Regulatory Reform, *Impact of RDA Spending – National Report – Volume 1 – Main Report* (Berr, March 2009) 22 <http://www.berr.gov.uk/files/file50735.pdf> assessed 2 May 2014. See also, Department for Business, Enterprise and Regulatory Reform (Berr), *Impact of RDA Spending – National Report – Volume 2 – Regional Annexes* (Berr, March 2009) <http://www.berr.gov.uk/files/file50736.pdf> accessed 2 May 2014; and R Tyler, 'Regional development agencies 'deliver value for economy' *Daily Telegraph* (London, 31 March 2009) <http://www.telegraph.co.uk/finance/5084548/Regional-development-agencies-deliver-value-for-money.html> accessed 2 May 2014> accessed 29 September 2014.
[151] 'KPMG: Green taxation "rapidly evolving" global trend' (*businessGreen: sustainable thinking*, 6 April 2013) http://www.businessgreen.com/bg/news/2264195/kpmg-green-taxation-rapidly-evolving-global-trend accessed 2 December 2013.

to redevelop contaminated land. Again, this further informs the interviewees' perceptions of risk in later chapters.

1. The Landfill Tax

The landfill tax is a form of taxation that is applied to the disposal of waste at landfill.[152] Upon being brought into force, Part III of the Finance Act 1996[153] (and the Landfill Tax Regulations 1996)[154] created a weight-based, as opposed to an *ad valorem*, system of taxation for the disposal of waste to landfill sites.[155] This taxation was levied to decrease reliance on depositing waste at landfill,[156] and to encourage the use of the greener forms of waste management.[157] The landfill tax, which used to be administered through the direction of the Commissioners of Custom and Excise,[158] is charged to the 'landfill site operator'[159] on the disposal of waste at landfill.[160] There are presently two rates that are imposed:[161] (1) the 'lower rate';[162] and, (2) the 'standard rate'.[163] Upon being brought into force, the Finance Act 1996 added a number of 'exceptions' to the rate of tax,

[152] Her Majesty's Revenue and Customs, 'Landfill Tax' (HMRC, no date), para 1. <http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageExcise_ShowContent&id=HMCE_CL_001206&propertyType=document> accessed 12 December 2013.
[153] Finance Act 1996.
[154] Landfill Tax Regulations 1996, SI 1996/1527.
[155] Her Majesty's Revenue and Customs, 'A general guide to landfill tax' (HMRC, 25 May 2004), para 5.1. <http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageExcise_ShowContent&id=HMCE_CL_000509&propertyType=document> accessed 2 December 2013.
[156] ibid, para 1.1.
[157] ibid.
[158] The Finance Act 1996, s 39(2).
[159] ibid, ss 41(1) and (2).
[160] ibid, ss 40(1) and (2).
[161] Licence or permit authorisation comes from Part II of the Environmental Protection Act 1990 or from the Pollution Prevention and Control Act 1999.
[162] HMRC, 'A general guide to landfill tax' (n 155), para 3.1. The 'lower rate' applies to the lesser polluting activities (being based at £2.50 per tonne for inactive material deposits) listed in section 18 of the Landfill Tax (Qualifying Material) Order 2011.
[163] ibid. The standard rate is currently priced at £80 per tonne, but increases annually.

whereby certain activities were excluded from payment of the fiscal charge. One of the qualifying activities for this exclusion was the deposit at landfill of any material that is generated through the development, or conservation, of contaminated sites.[164] In order to be eligible for exemption, the developer had to apply for a section 43B certificate.[165] However, the last date to obtain the section 43B certificate was in 2008.[166] This exclusion no longer applies, and all existing section 43B certificates were terminated in 2012.[167]

Now that landfill tax exemption no longer applies to contaminated material, developers will be less willing to regenerate such land. This could lead to an increase in orphan sites, and the fly tipping of contaminated waste around the UK. Removing the landfill tax exemption has further reduced the threat of direct liability under Part IIA. The revocation may have financial repercussions for developers, which may generate indirect and reputational risks for banks that have provided funding for contaminated land clean-up.

2. Land Remediation Relief

'A carrot rather than stick'[168] policy can be found in the tax incentive that currently offers economic relief from the costs of the remediation of contaminated land.[169] The policy, which was introduced by Schedules 22 and 23 of the Finance Act 2001,[170]

[164] Finance Act 1996, s 43A(1).
[165] ibid, s 43B.
[166] The Landfill Tax (Material from Contaminated Land) (Phasing out of Exemption) Order 2008, SI 2008/2669.
[167] ibid.
[168] J Chapper, 'A carrot and stick policy' (2008) EG 88.
[169] Finance Act 2009, pt 1 of sch 7 describes 'contaminated land' as land that is in such a condition that (a) relevant harm is being caused or (b) there is a serious possibility that relevant harm will be caused.
[170] Finance Act 2001.

implements a subsidy allowing companies to make a deduction of one hundred and fifty per cent for capital and revenue expenditure (fifty per cent for qualifying expenditure) incurred within the accounting period through contaminated land remediation. It is called Land Remediation Relief (LRR),[171] and encourages companies to participate in the reclamation of many of the UK's most blighted sites. In order to apply for 'qualifying land remediation expenditure'[172] there are a number of conditions that must first be met. The law states that the remediation must be conducted on land that is in a contaminated state.[173] Also, a company, or an individual acting on the company's behalf, must apply for the deduction – individuals and partnerships are not included as a qualifying person for relief.[174] It is also an important requisite that the company applying for funding must not have been the creator of the contamination.[175] Finally, the fiscal relief does not allow for the expenditure to be subsidised.[176] If all of these conditions are met, the company must elect for the tax deduction within two years of the accounting period in which remediation began.[177] Under the scheme, when a company remediates contaminated land, and makes a loss, the government allows it to apply for a tax credit of up to sixteen per cent, claiming back any losses incurred.[178] This tax credit has been created to put a safety net under the development of environmentally contaminated and suspect sites, thus reducing risk.

[171] Her Majesty's Revenue and Customs, 'Land Remediation Relief: contents' (HMRC, no date) <http://www.hmrc.gov.uk/manuals/cirdmanual/cird60050.htm> accessed 2 December 2013.
[172] Finance Act 2001, s 2(1).
[173] ibid, s 2(2).
[174] ibid, s 2(3).
[175] ibid.
[176] ibid, s 2(6).
[177] HMRC, 'Land Remediation Relief: contents' (n 171).
[178] ibid.

There was a period when it seemed that LRR, too, would be 'phased out' in the government's effort to cut funding.[179] However, LRR will now remain as a result of the responses that were made to the consultation concerning, 'the abolition of 36 tax reliefs.'[180] The Treasury's report on the abolition of tax relief suggests that, 'approximately 1,300 companies a year claim this relief costing the Exchequer around £40 million'.[181] The document goes on to state that, 'Respondents argued that removing this relief would affect the regeneration of uneconomic brownfield sites … [and] … would make a significant number of their planned projects financially unviable.'[182] Unviable sites will inevitably have adverse financial consequences for borrowers, which will consequently impact upon lenders. Respondents also claimed that this incentive was needed, because of the abolition of the landfill exemption for contaminated materials. The overall response to the revocation of LRR produced a favourable result in the end. The Government agreed that abolishing LRR and the landfill exemption would, 'exacerbate financial pressures', which would risk, 'undermining the Government's plans to support the housing and construction sectors.'[183]

[179] Newzeye, 'Osborne smashes brownfield targets and remediation relief' (*brownfieldbriefing*, no date) http://www.brownfieldbriefing.com/news/osborne-smashes-brownfield-targets-and-remediation-relief accessed 2 December 2013.
[180] Her Majesty's Treasury, *The abolition of 36 tax reliefs: response to the consultation* (HM Treasury, December 2011).
[181] ibid, para 2.13.
[182] ibid.
[183] ibid, para 2.14.

IV. Research Method

This section outlines how the 'social research'[184] was conducted, i.e. it describes the research method that was used to collect data. During October 2012 – January 2013, the researcher undertook fifteen semi-structured interviews with professionals with knowledge of environmental risk management in banks. The interview data collected are primarily presented in the last three chapters of this thesis. This chapter therefore offers an essential link to the following chapters. The structure of this section is as follows: first, the research's funding and collaboration is outlined; secondly, a description of the interviewing technique (i.e. semi-structured interviewing) is given; thirdly, the transcription and analysis of the data is assessed; and, finally, the chapter highlights the ethics consideration within the empirical study.

A. Funding and Collaboration

The Knowledge Economy Skills Scholarship (KESS) supported this research. KESS is 'a major European Convergence Programme',[185] which is funded by European Social Funds (ESF). KESS projects are described as: 'collaborative Doctoral and Research Masters awards in Welsh Universities, jointly sponsored by partners who are based in the Convergence areas of Wales.'[186] Ashfield Solutions, the partnership company to this project, jointly funded this PhD research. Ashfield's head office is based within the convergence area of Rhondda Cynon Taf (RCT). The company provides independent

[184] A Bryman, *Social Research Methods* (OUP 2012) 4.
[185] KESS, 'Knowledge Economy Skills Scholarships (KESS)' (*KESS website*, no date) <http://www.higherskillswales.co.uk/kess/> accessed 29 September 2014.
[186] Cardiff University, 'Knowledge Economy Skills Scholarships (KESS) at Cardiff University' (*Cardiff University website*, no date) <http://www.cardiff.ac.uk/racdv/expertise/kess/> accessed 26 August 2013.

land, waste and water advice across a number of different sectors, including banking.[187] It is important to mention the source of the research's funding, and the researcher's collaboration with the external partner, as this governed, in part, the choice of research subject. KESS projects are specific to 'an area of interest for the company partner.'[188] For Ashfield, the area of interest was lender liability for environmental damage, as banking is a major sector in which Ashfield works. Consequently, the company wanted to be a part of research, which contributes original data to the knowledge of this area. The researcher had to understand and meet, both, the expectations of KESS, and the partnership company. The following section describes the research method used to collect empirical data, i.e. semi-structured interviewing.

B. Semi-structured Interviewing

Rapely describes interviewing as, 'The central resource through which contemporary social science engages with issues that concern it.'[189] Social research methodology can be divided into qualitative and quantitative techniques.[190] However, some academics advocate the use of 'mixed-methods' approaches,[191] which is also known as 'triangulation'.[192] For this project, the qualitative technique of semi-structured

[187] Ashfield Solutions' website: <http://www.ashfieldsolutions.com/> accessed 9 December 2014.
[188] KESS, 'KESS – Quick Facts for Students' (*KESS website*, no date) <http://www.higherskillswales.co.uk/kess/faq-students.php.en> accessed 29 September 2014.
[189] TJ Rapely, 'The art(fulness) of open-ended interviewing some considerations on analysing interviews' (2001) 1 Qualitative Research 303, 304.
[190] Bryman (n 184) 38.
[191] A Bryman, 'Integrating quantitative and qualitative research: how is it done?' (2006) 6 Qualitative Research 97.
[192] TD Jick, 'Mixing Qualitative and Quantitative Methods: Triangulation in Action' (1979) 24(4) Administrative Science Quarterly 602.

interviewing was used as the empirical research method to collect data. The researcher's reasons for using this interviewing technique are now outlined.

1. Why Use Semi-structured Interviews?

The reason for setting up the semi-structured interviews was to gain an up-to-date understanding of the effect that the specific environmental risks have had on financial institutions' risk management frameworks. The data also provide the research with original knowledge of the research area.

So, why was semi-structured interviewing chosen over other methods of interview research? A deductive approach was used to establish the research questions for the thesis. Qualitative research obtains, 'descriptions of the life world of the interviewee.'[193] It was apparent that this type of interviewing style would allow the greatest insight into the subject area. Also, there are relatively few research methods that allow the same degree of social interaction between the researcher and his or her interviewees.[194] This leads Warren to suggest that, 'The purpose of most qualitative interviewing is to derive interpretation, not facts or laws, from respondents talk.'[195]

Structured interviewing was reviewed as a possible research method, although it did not appear as efficient for this project as the semi-structured interview style. A structured interview is categorised as a quantitative technique,[196] as the interview questions are closed, and do not allow much room for the interviewee to deviate on

[193] S Kvale, *Doing Interviews* (Thousand Oaks, Sage 2007) 8.
[194] ibid.
[195] CAB Warren, 'Qualitative Interviewing' in JF Gubrium and JA Holstein's (eds), *Handbook of Interview Research: Context & Method* (Thousand Oaks, Sage 2002) 454.
[196] Bryman (n 184) 208.

tangents when answering the questions.[197] This technique is more concerned about the collection of data, as opposed to the opinions of the interviewees.[198] In comparison to structured interviewing, the qualitative interview is more of 'an interaction between an interviewer and respondent'.[199] It is essentially a 'conversation', which is guided by the interviewer.[200]

Unstructured interviews are also a possible technique for data collection;[201] however, such an interviewing style was too flexible for this project. This form of interviewing allows such a wide degree of discretion for the participants when answering questions that it seemed difficult to formulate a transcript that would be of sufficient use at the analysis stage. The researcher felt that the semi-structured interview creates, over all the other methods, a unique relationship between the interviewer and their interviewees. Bude neatly depicts the interviewer-interviewee relationship as:

> 'A fellow traveler on a train journey to whom one tells one's entire life history. The limited nature of the contact seems to be a condition for the extraordinary truthfulness of this relationship.'[202]

Now that the reasons for choosing semi-structured interviews as a research method have been noted, the next section assesses the research strategy and sampling technique used to collect interview data.

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[197] ibid.
[198] ibid.
[199] ER Babbie, *The Practice of Social Research* (Cengage Learning 2007) 306.
[200] ibid.
[201] Bryman (n 184) 212.
[202] H Bunde, 'The Art of Interpretation' in U Flick, Ev Kardorff and I Steinke (eds), *A Companion to Qualitative Research* (Thousand Oaks, Sage 2004) 323.

2. Research Strategy and Sampling Technique

In his book, Kvale suggests that a qualitative interview study should consist of seven primary stages: (1) Thematizing; (2) Designing; (3) Interviewing; (4) Transcribing; (5) Analyzing; (6) Verifying; and, (7) Reporting.[203] Kvale's seven stages were followed throughout this empirical study. While the data sample purposively targeted bankers specialising in environmental risk management, not all participants to the study were bankers. The participants to this empirical research project comprise: twelve bankers, two environmental consultants, and an environmental insurance specialist. The opinions of the environmental consultants and environmental insurance specialist were relevant to the research questions. They had experience of the banking sector so that the researcher can justify including such participants within the data sample.

The bankers that participated in the research project came from a variety of banks (i.e. high street clearing and investment banks). All participants were chosen under the non-probability sampling technique that is commonly termed as 'snowball sampling'.[204] Bryman describes snowball sampling as:

> 'a sampling technique in which the researcher initially samples a small group of people relevant to the research questions, and these sampled participants propose other participants who have had the experience or characteristics relevant to the research.'[205]

[203] Kvale (n 193) 36-37.
[204] Bryman (n 184) 424.
[205] ibid.

As described above, 'snowball sampling' allows researchers to use an initial subject to obtain further contacts.[206] In relation to the snowballing technique, Heckathorn commented in a paper that, 'This nonprobability form of snowball sampling became a widely employed method in qualitative research on hard-to-reach populations.'[207] Biernacki and Waldorf believe that this sampling technique improves the 'social visibility' of target populations.[208] The researcher's primary task in this project was to conduct interviews in a hard-to-reach, small sample population, consisting of elite professionals. The snowballing technique allowed the researcher to use the interviewees' contact lists to identify other subjects quickly and effectively. Participants therefore acted as 'gatekeepers'[209] within the study; their knowledge and network of colleagues held the key for broadening the data sample. However, having a small sample in addition to using the snowball technique is subject to limitations (see the limitations' section below).

3. Gaining Access[210]

All interview research is capable of having access issues.[211] In this study distance inhibited the researcher's ability to conduct face-to-face interviews with all of the interview respondents. The interviewees worked in the banks' Head Quarters, in financial centres on both sides of the Atlantic. Accordingly, it was necessary to conduct

[206] R Atkinson and J Flint, 'Snowball Sampling' in MS Lewis-Beck, A Bryman and T Futing Liao's (eds), *The SAGE Encyclopedia of Social Science Research Methods* (Thousand Oaks, CA; Sage Publications 2004) 1044-1045.
[207] DD Heckathorn, 'Comment: Snowball Versus Respondent-driven Sampling' (2011) 41(1) Sociological Methodology 355, 356.
[208] P Biernacki and D Waldorf, 'Snowball Sampling: Problems and Techniques of Chain Referral Sampling' (1981) 10(2) Sociological Methods & Research 141, 144.
[209] I Seidman, *Interviewing as Qualitative Research: A Guide for Researchers in Education and the Social Sciences* (Teachers College Press 2012) 47.
[210] For a good textbook on 'gaining access' see, MS Feldman, J Bell and MT Berger, *Gaining Access: a practical and theoretical guide for qualitative researchers* (AltarMira Press 2003).
[211] ibid, vii.

some of the interviews over the telephone, and through the use of video conferencing software (i.e. Skype). Gaining access was surprisingly difficult at the beginning of the research, as it was challenging to find interviewees. To overcome this difficulty, the researcher drafted a table of twenty-nine financial institutions (this table also included the various interview candidates), which had knowledge that was relevant to the research. This process was aided by the use of contacts that the researcher met in the project's first year. However, the most invaluable source for gathering potential data subjects was the Internet (the individual institutions' websites, LinkedIn, etc.). When the candidate list was completed, a strategy for contact was implemented. This strategy consisted of sending letters, emailing, and 'cold calling' the people on the contact list. While the latter proved the most ineffective strategy for establishing contact with participants, sending emails was by far the most successful. However, this does not necessarily mean that email was the fastest means of accessing the data sample. The biggest problem with emails was that it was sometimes difficult to get potential participants' email addresses. Also, some of the people contacted took a long time to respond, and many were unwilling to participate because of confidentiality concerns, and more urgent business commitments. In some cases bureaucracy was a problem, as consent was needed from both the company, as well as the interview participant.

4. The Project's Topic Guide and Interviews

The empirical study consisted of fifteen semi-structured interviews with elite banking and other professionals, with knowledge and understanding of the research area. In accordance with the confidentiality requirements of the study, specific individuals or organisations cannot be identified in any part of the thesis or other related publications. It is nevertheless necessary, since the interview subjects' data make the work original,

to display some generic information about the respondents at the time when the interviews were conducted; this ultimately supports the conclusions that are made in the thesis. The interviewees and organisations that took part in the empirical study are conspicuous because of the use of specific titles to describe job positions. Confidentiality is however assured in the thesis by the grant of anonymity, and the use of generic labelling. For example, in the table below specific job titles, which may lead to the identification of individual persons or organisations, are replaced with more general headings, i.e. 'Consultant', 'Senior Manager' or 'Director'.

Respondent	**Country Base**	**Level of Seniority**	**Employment**
Respondent 1	London, UK	Senior Manager	Banking, Environmental Risk
Respondent 2	London, UK	Senior Manager	Banking, Environmental Risk
Respondent 3	London, UK	Senior Manager	Banking, Environmental Risk
Respondent 4	London, UK	Senior Manager	Banking, Environmental Risk
Respondent 5	New York, USA	Senior Manager	Banking, Environmental Risk
Respondent 6	Toronto, CAN	Senior Manager	Banking, Environmental Risk
Respondent 7	London, UK	Senior Consultant	Consultancy, Environmental Risk

Respondent 8	Amsterdam, NL	Senior Manager	Banking, Environmental Risk
Respondent 9	London, UK	Senior Manger	Insurance, Environmental
Respondent 10	London, UK	Senior Manager	Banking, Environmental Risk
Respondent 11	London, UK	Senior Manager	Banking, Environmental Risk
Respondent 12	London, UK	Senior Manager	Consultancy, Environmental Risk
Respondent 13	Zürich, CH	Manager	Banking, Environmental Risk
Respondent 14	Zürich, CH	Senior Manager	Banking, Environmental Risk
Respondent 15	Manchester, UK	Senior Manager	Banking, Environmental Risk

It was necessary to confine the boundaries of the research. To do this, the researcher set a 'cut off point' for the maximum amount of interviews at fifteen. In any case, this number of interviews is representative of the sample population, since it is small in nature. Interviews were held face-to-face,[212] or by telephone.[213] One interview was conducted through Skype. It took a period of four months to find, conduct and transcribe the interviews. The first interview was held on 4 October 2012; the last took

[212] A Irvine, P Drew and R Sainsbury, "'Am I not answering your questions properly?' Clarification, adequacy & responsiveness in semi-structure telephone & face-to-face interviews.'" (2012) 13 Qualitative Research 87.
[213] Bryman (n 184) 488.

place on 28 January 2013. While 'setting up the interview',[214] the potential interview participant that had been found was asked, by phone or email, whether they would be willing to agree to take part in an interview for the research project. An electronic device recorded all of the interviews. All interviewees were given the opportunity to decline the use of the electronic recording device. Every contact that agreed to participate in an interview also permitted the use of the recorder. With elite interviewees, this could be, as Rubin and Rubin suggest, because, 'people like to talk about themselves: they enjoy the sociability of a long discussion and are pleased that somebody is interested in them.'[215] Once the fifteen interviews had been completed, the transcription and analysis process continued until the end of April 2013.

Before the interviews were undertaken, the researcher drafted an interview guide that accords to the flexible approach that is to be taken during semi-structured interviewing.[216] The interview guide used is included in an appendix to this thesis.[217] With regards to the use of an interview guide, Bryman notes:

> 'The idea of an interview guide is much less specific than the notion of a structured interview schedule … What is crucial is that the questioning allows interviewers to glean the ways in which research participants view their social world and that there is flexibility in the conduct of the interviews.'[218]

[214] Warren (n 195) 90.
[215] HJ Rubin and IS Rubin, *Qualitative Interviewing: the Art of Hearing Data* (Thousand Oaks, Sage 1995) 103.
[216] Bryman (n 184) 442.
[217] infra, app 3, pg 424.
[218] Bryman (n 184) 442.

The guide that was used was short, and only served to act as a 'memory prompt'.[219] Interviewees were permitted to deviate from the interview guide, so long as the deviation was both useful and relevant to the research project. Within this study, the researcher began each interview with an opening question. This question was often general, and easy to answer. For example, 'Could you please state your name and position in the company?' or, 'Generally, what do you think about environmental risk and due diligence in modern banking practices?' Although the student worked from an interview guide, the same sorts of questions and answers appeared. Despite this, no interview transcript was exactly the same.

5. The Limitations of Semi-structured Interviewing

This methodology section has shown that there are many advantages with using semi-structured interviewing as a research method. That being said, semi-structured interviewing also has limitations. Common criticisms of this interview technique suggest that the method is often too subjective, and that the findings are very difficult to replicate.[220] Thus, one may argue that qualitative data may not always present a true depiction of the existing social phenomena since another interviewer, who is influenced by different values, could produce wholly different results.[221]

Semi-structured interviewing is, compared to some quantitative techniques, viewed as a flexible interview style. However, too much flexibility can be quite onerous. Some interviewers may attempt to lead interviewees (although indirectly) to the answer they

[219] ibid.
[220] ibid.
[221] ibid.

want, as opposed to obtaining the participant's own view on the subject matter. Alternatively, there is the fear that the interviewee will take too much control over the interview and disrupt its flow. That is why a good interview guide is important.

The snowball sampling technique was used to obtain interviewees. As a result of the data sample for this project being small and hard-to-reach (i.e. elite banking professionals working in a sufficiently closed setting), the snowballing technique was the logical choice for obtaining interview subjects. However, using snowball sampling to collect interview data from a small sample population can be subject to limitations. The primary issue is that the reliability of the findings is capable of being brought into question as a result of the possibility of biased data.[222] The initial interview subjects that were asked to share their contacts are likely to have referred only their close friends and colleagues. It is to be expected that the members of such a close-knit social network are of a shared opinion on a number of matters, and represent only a small section of the research sample. Snowball sampling can therefore lead to biased data because the different opinions that can exist in a population of potential interview participants may not have been fully considered. Biernacki and Waldorf note this particular issue with snowball sampling in their paper: 'Or will the exclusive use of the method yield a biased sample by revealing only those cases discovered through existing social networks?'[223]

Despite snowball sampling's likelihood of producing biased data, when interviewing elites it is often difficult to obtain a large number of interviewees with the desired knowledge and understanding of the research topics. Moreover, it may be argued that conducting only a small number of elite interviews should not reduce the data's ability

[222] Biernacki and Waldorf (n 208) 161.
[223] ibid.

to provide a valid insight. Adler and Adler believe that, 'Moving up, a small number of cases, or subjects, may be extremely valuable and represent adequate numbers for a research project.'[224] They go on to suggest that, 'This is especially true for studying hidden or hard to access populations such as deviants or elites. Here, a relatively few people, such as between six and a dozen, may offer us insights'.[225] In light of Alder and Adler's comments on snowball sampling and small sample populations, the researcher finds that the amount of interviews that were conducted have provided: (1) sufficient coverage of the sample population; and (2) a valid insight into the lenders' current attitudes towards environmental risks and due diligence in banks.

Another primary risk with 'snowball sampling' is that access issues can easily prohibit contact with the data sample.[226] The main limitation that the researcher found when using this method was that it placed too much reliance upon the researcher's ability to build a good *rapport* with the interviewees.[227] Asking an interview participant for their contact list puts pressure on the interviewer-interviewee relationship. To resolve this, the researcher asked politely in a follow up 'thank you' email to the participant whether they would be willing to provide the names and email addresses of any persons they think may be interested in the research project. This approach was successful with the majority of participants.

Finally, the use of the digital recorder could also be described as a limitation to this qualitative study. Even though digitally recording an interview is highly beneficial for

[224] PA Adler and P Adler, 'Expert Voices' in SE Baker and R Edwards (eds), *How many qualitative interviews is enough?* (National Centre for Research Methods Review Paper, no date) 8 <eprints.ncrm.ac.uk/2273/4/how_many_interviews.pdf> accessed 23 July 2015.
[225] ibid.
[226] Warren (n 195) 87.
[227] Bryman (n 184) 458.

the interviewer, there is evidence to suggest that the use of recording equipment may have an impact upon the interviewee. Warren, for instance, raises this point:

> 'But does the respondent remain basically unaffected by this? Not only might turning on a tape recorder alter the ensuing conversation, creating a particular context for what is said, but the meanings of audio- or videotaping may be different to different respondents'.[228]

The adverse impact that a recorder may have upon an interviewee may be particularly so with elites, who have their careers and companies' reputations to think about. In this study, some of the subject areas on the topic list (e.g. 'How much contaminated land the bank has in its possession?') made specific interviewees put up a 'corporate front' in order to protect their interests. Different types of interview questions were deployed in order to overcome this limitation.

C. Transcription and Analysis

Following Kvale's fourth stage of qualitative interviewing,[229] once an interview had been completed, the recording of the conversation was transcribed, *verbatim*. When all the interviews had been transcribed, the transcripts were posted out to the participants for corrections; following this, a thematic analysis of the interview data was undertaken. Transcripts can be coded manually, or through the use of computer-aided qualitative data analysis software (CAQDAS),[230] e.g. NVivo.[231] The empirical research undertaken

[228] Warren (n 195) 91.
[229] Kvale (n 193) 37.
[230] Bryman (n 184) 590.
[231] ibid 593.

in this circumstance did not generate such high volumes of information that justified the use of computer-aided coding. Thus, the data were coded manually, since it was fairly easy for the researcher to assess the data by memory, and incorporate sections of the interview transcripts throughout the thesis. Kvale describes this process as, 'a deconstruction of the interview text.'[232]

Coding categories were created to assist the analysis process. Explaining the basis on which the coding for the results was carried out is necessary for linking the data to the conclusions that are made within the thesis. The information in this section appears in the 'research findings' section of Chapter 8, the concluding chapter; and, to a lesser extent, Chapter 7, which contains more empirical data than any other chapter in the thesis. The categories were drawn deductively by the use of the individual sub-questions. Different coloured highlighters were used to identify relevant data:

Sub-question	**Coding Category**
SQ 1: What are the more threatening environment-related risks for the UK bank lending community today?	Green
SQ 2: How do lenders exercise and shape their due diligence functions to manage and assess the environment-related risks?	Blue
SQ 3: What are the main drivers for the use of environmental risk management in banks?	Yellow

[232] Kvale (n 193) 115.

Data relating to the sub-questions' individual bullet points were highlighted in the generic coding colours (as above), and then further underlined with different coloured writing pens:

Sub-question / Point	Coding Category	Underline
SQ 1, Point 1	Green	Blue
SQ 1, Point 2	Green	Red
SQ 1, Point 3	Green	Black
SQ 2, Point 1	Blue	Blue
SQ 2, Point 2	Blue	Red
SQ 2, Point 3	Blue	Black
SQ 3, Point 1	Yellow	Blue
SQ 3, Point 2	Yellow	Red
SQ 3, Point 3	Yellow	Black

Hence, a green highlighter with red underline coded any data that were relevant to sub-question 1, point 2 (i.e. 'How do banks currently rank the environmental risks in relation to the threat that they pose to the banks?'), and so on. When all the data had been coded in accordance with the categories listed above, it was then possible to undertake a thematic analysis of the coded data. Page 245 of this thesis, for instance, shows some of the coded data that were relevant for answering sub-question 1, point 2. Respondent 10 said in interview, *'Okay, well the risks are many. The two biggest ones are reputational risk and credit risk.'* In addition, Respondent 13 stated, *'Currently, I would rate reputational risk higher than… well… first – reputational risk, secondly – credit risk, thirdly – liability and market risk.'* It can therefore be deduced from this

data set that the lending community presently ranks reputational risk and the indirect risks as more threatening environmental risks than lender liability.

D. Ethics Consideration

This qualitative study was submitted to Cardiff University's ethics committee for approval. Such approval is necessary before any empirical research involving human subjects can be undertaken. For this particular study, ethical issues were not too troublesome, and the qualitative research received the committee's endorsement.

For Kvale, interviewing is a moral enterprise that is, 'saturated with moral and ethical issues.'[233] He further adds that, 'Ethical problems in interview research arise particularly because of the complexities of researching private lives and placing accounts in the public arena.'[234] Kvale portrays 'the interview' as more than just a conversation between persons, suggesting that such an experience transcends the moral-philosophical realm known as ethics.[235] In order to reduce the threat of incurring ethical issues within a project, a piece of empirical research should take into account Diener and Crandall's four questions:

- Is there harm to participants?

- Is there a lack of informed consent?

[233] ibid, 23.
[234] ibid.
[235] ibid. See also, Bryman (n 184) 129.

- Is there an invasion of privacy?

- Is deception involved? [236]

Kimmel rightly believes that ethics considerations reside, according to their threat of harm, in a typology.[237] He states that the obvious parties that could incur harm are the interview participants.[238] Furthermore, the researcher must also consider things like the project's impact upon society, as well as the body of knowledge to which the work will finally be attributed.[239]

The empirical study for this project dealt with interviewing elites,[240] i.e. bankers and other educated professionals. The researcher was careful not to harm the participants that took part in the interviews. He was aware that the 'private lives' of the different participants would be exhibited within the 'public arena': specific extracts of the interview transcripts are made publically available by the thesis.[241] Due to the high-powered careers of the interviewees, confidentiality and informed consent were important to consider. It was crucial that an interviewee would not face repercussions with their employer or clients because of something that they had said in interview. In order to limit harm to interviewees, the researcher did four things:

- Granted each participant anonymity;

[236] E Diener and R Crandall, *Ethics in Social and Behavioural Research* (University of Chicago Press 1978). Diener and Crandall's four question for ethical conduct are also listed in, Bryman (n 184) 135.
[237] AJ Kimmel, *Ethics and Values in Applied Social Research* (Sage 1988) 36.
[238] ibid.
[239] ibid.
[240] WS Harvey, 'Methodological Approaches for Interviewing Elites' (2010) 4(3) Geography Compass 193.
[241] Kvale (n 193) 115.

- Stored data in a safe way, and according to the law;

- Sent the interview transcript to the participant (once transcribed); and,

- Drafted a consent form.

Anonymity remains an important feature of this research. In no part of the thesis is it possible to identify individual persons or organisations. This is assured in the referencing of interview extracts. Throughout this thesis, an 'R' preceded by a number, references individual participants. Accordingly, 'R_{10}' would be used to reference an extract from Respondent 10's interview transcript, and so on.

All 'personal data' collected within this study have been stored pursuant to the eight principles of data protection set out within the Data Protection Act 1998.[242] The sensitive data have been placed onto a memory stick, and written in word documents (as a result of the transcripts). These sources of storage are encrypted, and only the researcher has access to the passcodes.

To further protect participants from undue harm, interviewees were sent a copy of their interview transcripts. Upon receipt of the draft transcript, amendments and corrections could be made by the interviewee. If a banking respondent was unhappy about what they said in a particular section of the interview, they had the opportunity to delete the section from the document. A few interviewees felt it necessary to remove large

[242] The Data Protection Act 1998, s 4 and sch 1.

sections of text from their interview transcripts. The majority of the respondents made minor corrections to clarify some of the points made within the text.

Before each interview, the researcher sent the participant the necessary *pro forma* documentation, including: (1) the information sheet; (2) a consent form; (3) the research hypothesis; and, (4) the topic guide. The information sheet provided a general *tour d' horizon* of the researcher's contact details, and the research project. The consent form was drafted in order to ensure that the participant's participation in the research project was done on a voluntary basis, and, by signing the consent form, the participant had expressly agreed that they had engaged in the project on the basis of the assurances of confidentiality given to them, and under their own free will. The final two documents were created to aid the researcher during the interview. All of the documents listed in this section are appended.[243]

The researcher strongly believes that the measures that have been taken within this empirical study have successfully helped to reduce the threat of unethical conduct from materialising within the study.

V. Structure

Chapters 2 – 4 outline the legal basis for environmental risk in commercial bank lending. While Chapter 2 focuses specifically on the Part IIA regime, Chapter 3 provides an account of the more miscellaneous environmental liabilities, in addition to the emerging liabilities, that are likely to impact lenders' business operations. Chapter

[243] Refer to app 3, pg 424.

4 looks at the environmental issues that may arise for lenders during a client's corporate insolvency. These chapters provide a contemporary account of the various UK environmental laws and regulations that are likely to create risks for lenders and borrowers. These chapters are more doctrinal and legally technical than any other part of this thesis, providing an essential procedural component for this work.

Chapters 5 – 7 present the main research findings from the semi-structured interviews. Chapter 5 assesses the environmental risks. The risks are defined and ranked according to the interview data's analysis. Chapters 6 and 7 look at the banks' environmental due diligence techniques. Chapter 7 presents the interview data. The interviewees' insights are unique, and provide an original contribution to the research area.

Chapter 8 concludes the thesis. It discusses the research findings, and the implications and future research opportunities that have been created because of the study. Finally, a potential solution is provided for circumventing the use of direct lender liability as a means of remediating suspect land.

The references and appendices are held at the end of the thesis. While the references show the various types of literature that have been analysed over the last three years, the appendices hold some important documents, which further expand upon the methodological approach. For example, Appendix 1 shows a copy of the email that was circulated to the various environmental risk management teams in order to request an interview.[244]

[244] infra, app 1, pg 418.

VI. Conclusion

This chapter has outlined why the research is necessary by looking at the gaps in the literature basis, and the economic challenges currently facing the UK's contaminated land policy. It also presented an overview of the empirical research method. The methods section demonstrated how the interview data – which provides an original contribution to the knowledge of the research field – were collected, transcribed and analysed. The next chapter (Chapter 2) evaluates lender liability for historic contaminated land.

Chapter 2:
Lender Liability and Historical Land Contamination – Part IIA of the EPA 1990

An overview of the lender liability threat from historic land pollution is provided in this chapter. First, lender liability for contaminated sites under America's Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C., section 9601 *et seq.* is discussed.[245] Secondly, the chapter looks at the UK's contaminated land regime, introduced in 2000 by Part IIA of the Environmental Protection Act 1990.[246]

The chapter provides an essential legal component for the thesis, since a detailed account of the contaminated land regime is provided. Chapter 2's relevance can be attributed to the fact that it offers a legal understanding for why a paradigm shift in the banks' perceptions of the environmental risks has occurred. It therefore answers the overarching research question and sub-question 1, which ask about the threat of the environmental risks, and whether environmental legislation presents any real risk for banks.

[245] Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C., s 9601 *et seq*.
[246] EPA 1990, s 78.

I. Historic Land Contamination in the United States

A. Introduction

It is necessary to analyse the United States' environmental lender liability because, as Jarvis and Fordham suggest:

> 'The US provides the furthest developed illustration of primary lender liability. American lenders have found themselves responsible for clean-up costs arising from the polluting activities of their borrowers.' [247]

Following Jarvis and Fordham's reasoning, UK lenders began to use the USA as a 'template' in order to create and develop their own risk management strategies for reducing the threat of lender liability from specific environmental legislation (e.g. Part IIA of the EPA 1990). The empirical data show that, today, US bank lenders continue to take a strict liability-based approach to characterising environmental risk.[248] This is different to the environmental due diligence methods used in European banks.[249] The stricter use of environmental due diligence in American banks may be as a direct result of CERCLA, and the need for companies to disclose their environmental information.

> *R_5: We would look at how the company's involvement is translated into costs. Going back to the accounting rules that I mentioned upfront in the liability, if a company has Superfund sites, they must disclose that amount on their financial statements, because they tend to be material; unless, you*

[247] Jarvis and Fordham (n 51) 10.
[248] infra, ch 7, pg 327.
[249] ibid.

> *have a .001 responsibility for a site that will take $100 million to clean up, it may not be a material amount. Generally, companies in the US, especially the public companies, they do a 10K, or 20F if they are a foreign filer, will disclose.*[250]

When introduced, CERCLA caused a fear of lender liability to spread throughout the US bank lending community. Now, however, it seems that the American lenders are turning their attention to potential liabilities that may be incurred through funding businesses that operate in emerging markets.

> *R_5: What I am being to look at more closely are things that could be construed as a potential Superfund site overseas in an emerging economy; so if we are dealing with a Chinese company or Indonesian company uhm that has been known to dump its waste or store it an unhealthy and unsafe way, we can very well assume that, at some point, that is going to have to be resolved and it might be quite expensive to do so.*[251]

The following section provides an overview of the CERCLA regime. It also serves as an introduction to later discussion on Part IIA of the EPA 1990.

[250] Interview with Respondent 5.
[251] ibid.

B. Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the Original Secured Creditor Exemption[252]

The US Congress passed CERCLA in 1980. CERCLA introduced a regime that was largely designed to respond to abandoned hazardous waste sites situated throughout the US. The regime aims to reduce the threat that contaminated land posed to human health. CERCLA's creation was driven by, *inter alia*, the site at Niagara Falls, N.Y., which was used by the Hooker Chemical Company to dump toxic waste for twenty-five years (i.e. the Love Canal site).[253] CERCLA initially relied on a superfund that was used for remediation purposes until, on 30 September 1994, Congress did not re-authorise the provision of CERCLA that allowed the fund to be replenished annually by an industrial levy. Superfund has since been funded by annual appropriations by the US Congress.

Liability under the regime is strict and retrospective and there are four 'potentially responsible parties' (hereafter, PRPs) that could be held liable for the remediation of hazardous waste.[254] Accordingly, an 'owner and operator[255] of a vessel or a facility' is capable of incurring clean-up costs as a PRP under CERCLA.[256] The United States Environmental Protection Agency (US EPA), the administrator of CERCLA,[257] can

[252] Since 1980, the 'secured creditor exemption' has been amended by judicial interpretation and legislative reforms. Thus, this section uses the 'original secured creditor exemption' to describe the one that was initially drafted into CERCLA in 1980.
[253] For a good overview of the 'Love Canal Tragedy', see EC Beck, 'The Love Canal Tragedy' (*United States Environmental Protection Agency website*, no date) <http://www2.epa.gov/aboutepa/love-canal-tragedy> accessed 31 August 2014.
[254] 42 U.S.C. s 9607(a).
[255] ibid, s 9601(20)(i)-(iii).
[256] ibid, s 9607(a)(1).
[257] ibid, s 9601(2).

order PRPs to undertake clean-up operations,[258] or conduct remediation works itself and recover the costs incurred.[259] Remediation costs are determined on the basis of the particular vessel or facility that created the damage.[260] Remediation costs for facilities are unlimited.[261] Also, if the President[262] determines that a source of hazardous substances may be an 'imminent and substantial endangerment'[263] to society or the environment then the US EPA issues an order to prevent the harm from materialising.[264] Despite its use, 'imminent and substantial endangerment' is not defined in any section of CERCLA, and, instead, needs to be explained through its use in other legislation and CERCLA case law. In the case of the *United States v Northeastern Pharm & Chem Co*, 579 F Supp 823 (WD Mo 1984), the court stated that the term 'imminent and substantial endangerment' should be assessed through, 'a case-by-case assessment of the relationship between the magnitude of risk and harm arising from the presence of the hazardous waste.'[265]

Any violation of an order may result in a $37,500 fine per day,[266] which may be issued until the violation's discontinuation.[267] To limit the scope of CERCLA's liability, Congress drafted an exemption into the law (i.e. 'the secured creditor exemption').[268]

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[258] ibid, ss 9604 and 9606.
[259] ibid, s 9607(a)(4)(A).
[260] ibid, s 9607(c)(1)(A)-(D).
[261] ibid, s 9607(c)(1)(C).
[262] Pursuant to section 9615: 'The President is authorized to delegate and assign any duties or powers imposed upon or assigned to him and to promulgate any regulations necessary to carry out the provisions of this subchapter.' The President's power is thus normally delegated to the administrator of CERCLA, the US EPA.
[263] See R Zimmerman, *Governmental Management of Chemical Risk: Regulatory Processes for Environmental Health* (Lewis Publishers 1990) 266.
[264] 42 U.S.C. §9606(a).
[265] *United States v Northeastern Pharm & Chem Co*, 579 F Supp 823, 846 (WD Mo 1984).
[266] United States Environmental Protection Agency, 'Updated Penalty Matrix for CERCLA Section 106(b)(1) Civil Penalty Policy' (*United States Environmental Protection Agency website*, 17 July 2009) <http://www2.epa.gov/sites/production/files/2013-10/documents/106-matrix-rev-09.pdf> accessed 10 September 2015.
[267] 42 U.S.C. s 9606(b)(1).
[268] ibid, s 9601(20)(E).

This excluded liability as an 'owner or operator' if, 'without participating in the management of a vessel or a facility, a person holds indicia of ownership primarily to protect his security interest in the vessel or facility.'[269] This exclusion provided secured creditors with a 'safe harbour' from remediation liability under CERCLA.[270]

1. Judicial Interpretation of the Original Secured Creditor Exemption

Following CERCLA's introduction, the judiciary attempted to clarify the meaning of the secured creditor exemption (above). However, the courts differed in their determinations of the exemption and, it may be argued, skewed the intent of the legislator. The section below analyses two cases which provide opposing judicial interpretations of CERCLA's original secured creditor exemption. It begins with the case of *United States v Mirabile* (1985) 15 Envtl L Rep. 20994.[271]

1.1. *United States v Mirabile*

The District Court in *United States v Mirabile* (1985)[272] had to determine the US EPA's ability to allocate liability to financiers of an 'owner or operator' of a CERCLA site.[273] Turco, a paint manufacturing company, was identified as a PRP by the US EPA.[274] The company was pursued by the EPA for the payment of remediation costs.[275] During its

[269] ibid.
[270] Ahrens and Langer (n 65) 483.
[271] *United States v Mirabile* (1985)15 Envtl L Rep 20994. See also, *In re T.P. Long Chemical, Co.* 45 Bankr. 278 (Bankr. N.D. Ohio 1985), where BancOhio was not held liable under section 104(a) of CERCLA [at 288] for foreclosing on contaminated property.
[272] *Mirabile* (n 271).
[273] ibid, 20,993. See also, MJ Cobb, 'Where Will It End? Increased Risks to Lenders Under CERCLA Secured Creditor Exemption Law' (1991) 40 Journal of Urban and Contemporary Law 249, 252.
[274] *Mirabile* (n 271), 20,993.
[275] Cobb (n 273) 252.

operations, the American Bank and Trust (ABT) Company and the Mellon Bank financed Turco.[276] Later, the company became insolvent, applying for bankruptcy[277] under Chapter 11. But this action was dismissed,[278] and ABT foreclosed its securities.[279] The legal title of Turco's site was assigned to the Mirabiles, following ABT's successful bid at a sheriff's sale.[280] While all parties (i.e. the ABT, the Mellon Bank and the Mirabiles) were considered to be PRPs by the US EPA, this analysis will focus on ABT's position as a mortgagee in possession. ABT argued that it was simply following its normal procedure in the situation where a borrower is unable to service its loan agreement.[281] The bank claimed that it could not be made liable because it had only an equitable interest (i.e. it did not possess any legal title to the property, nor had it participated in managing the company).[282] The court ruled that a bank which 'merely foreclosed on the property after all operations had ceased and thereafter took prudent and routine steps to secure the property'[283] could not be classed as a PRP under CERCLA. Therefore, the court decided that the process of foreclosure does not qualify as an activity that could be held as 'participating in the management',[284] as this would require, at the very least, the bank's 'day-to-day' involvement in the management of a facility or a vessel.[285]

Mirabile offered a favourable judgment for secured creditors in the US. The court clearly understood the problems that lender liability can cause (e.g. a fear to lend

[276] *Mirabile* (n 271) 20,992.
[277] ibid, 20,995
[278] *Mirabile* (n 271) 20,994 – 20, 995.
[279] ibid.
[280] ibid, 20,993. Read, Cobb (n 273) 253.
[281] ibid, 20,996.
[282] ibid.
[283] ibid, 20,995.
[284] ibid, 20,996.
[285] ibid, 20,997.

money) and did not want to limit the applicability of the secured creditor exemption. However, the judgment in *Mirabile* was not followed in the case of *United States v Maryland Bank & Trust Co*. 632 F. Supp. 573 (D. Md. 1986),[286] which was heard a year later. In that case, Maryland Bank & Trust Co. (MG & T) was held liable under CERCLA for the remediation costs incurred by the US EPA. Cobb suggests that, 'Although the finding appeared to reject the holding in Mirabile, in reality it did not do so.'[287] The secured creditor exemption only applied to persons that hold a secured interest at the time of clean-up.[288] The facts of *Maryland* state that MG & T held a mortgage on the contaminated property on 16 December 1980 and foreclosed in 1981.[289] However, MG & T purchased the contaminated site at a foreclosure sale on 15 May 1982,[290] becoming a former mortgagee and waiving the right to rely on the exemption.[291] By becoming a former mortgagee the facts of this case are 'fact specific'[292] in comparison to *Mirabile*. Jarvis and Fordham describe the judgment in *Maryland Bank & Trust Co.* (1986)[293] as, 'the first real suggestion that Mirabile might [have been] too favourable to lenders.'[294] It is difficult to agree with them on this point; and the judicial decision in *United States v Fleet Factors* (1990) 901 F .2d 1550 shows why. This case is outlined below.

[286] S Alvarez, 'Taming the Environmental Protection Agency: Lender Liability in the Aftermath of Kelley v EPA' (1995-1996) 3 Hastings W-Nw J Envt'l L & Pol'y 465. Alvarez makes a useful distinction between the *Mirabile* and *Maryland* cases (e.g. in *Mirabile* the bank did not acquire title, whereas in *Maryland* the bank did). Thus, Alvarez suggests that a different interpretation of the secured creditor exemption had to be taken by the Maryland court.
[287] Cobb (n 273) 255.
[288] *United States v Maryland Bank & Trust Co* 632 F Supp 573 (D Md 1986) 579.
[289] ibid.
[290] ibid.
[291] ibid.
[292] Cobb (n 273) 255.
[293] *Maryland* (n 288) 579.
[294] Jarvis and Fordham (n 51) 14.

1.2. *United States v Fleet Factors*

Following the court's ruling in *United States v Fleet Factors Corp*, 724 F Supp 955, 960 (SD Ga 1988)[295] ('Fleet I'), the US Court of Appeals of the Eleventh Circuit heard the appeal in the case of *United States v Fleet Factors Corp* (1990) 901 F 2d 1550 ('Fleet II').[296] In *Fleet*, the court was asked to determine the extent to which a lender might be excluded from liability under CERCLA's secured-creditor exemption.

The facts of the case were as follows: A factoring agreement was made between Swainsboro Print Works (SPW), a textile facility, and Fleet Factors Corp. (the factoring company) in 1976.[297] Under this agreement, Fleet Factors advanced funds against the assignment of SPW's accounts receivable.[298] Fleet acquired a secured interest in SPW's facility and its 'equipment, inventory and fixtures', as collateral under the agreement.[299] In 1979, SPW filed for bankruptcy under Chapter 11,[300] but the factoring agreement continued under court order.[301] Fleet ceased to advance funds to the company in 1981 and, on 27 February 1981, SPW entered into bankruptcy proceedings.[302] Fleet continued to factor SPW's accounts receivable during this time.[303] Following SPW's liquidation in December 1981,[304] Fleet foreclosed on some of its securities in May 1982.[305] On 22 June 1982, Fleet held an auction, selling off some of the collateral.[306] It

[295] *United States v Fleet Factors Corp*, 724 F Supp 955, 960 (SD Ga 1988).
[296] *United States v Fleet Factors Corp* (1990) 901 F 2d 1550.
[297] ibid, 1552.
[298] ibid.
[299] ibid.
[300] ibid.
[301] ibid.
[302] ibid.
[303] ibid.
[304] ibid.
[305] ibid.
[306] ibid.

also contracted for the removal of the unsold property, leaving the site 'broom clean'.[307] Upon the US EPA's inspection of the property, on 20 January 1984, seven hundred drums of toxic substances were identified on the site.[308] Each drum contained 55 gallons of toxic waste. There was also a substantial amount of asbestos based material discovered on the land (estimates based it at around 40 lorry loads).[309] The US EPA, in pursuance of its statutory duties under CERCLA, remediated the site.[310] With remediation costs reaching around $400,000,[311] the Agency then demanded repayment from the parties who, in their determination, had caused the pollution.[312] The US EPA believed that responsibility for clean-up should be left with, amongst others, the factoring company, Fleet Factors.

In an interlocutory appeal brought by Fleet Factors (Fleet Factors I), the district court ruled that, despite the secured creditor exemption, 'Fleet's activities at the facility might rise to the level of participation in management sufficient to impose liability.'[313] On appeal, *Fleet Factors II* distinguished *Mirabile* on control grounds,[314] formulating its own conception of what is meant by 'indicia of ownership'. The court held that: 'a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose.'[315] Thus, if a lender had the 'capacity to influence the financial management'[316] of their borrowers' activities upon the land, the secured creditor

[307] ibid, 1553.
[308] ibid.
[309] ibid.
[310] ibid.
[311] ibid.
[312] ibid.
[313] ibid, 1550.
[314] ibid, 1558.
[315] ibid, 1157-1558.
[316] ibid, 1557.

exemption cannot be relied upon to exclude liability.[317] Such an interpretation meant that a lender could incur liability for remediation costs even with minimum control in its borrowers' affairs.[318]

This decision is a classic demonstration of where the judiciary has decided the case in order to make the party with the 'deepest pockets' liable for clean-up. The judgment created, what became known as, 'the CERCLA dilemma' for American lenders.[319] Lenders were unaware as to what type of relationship they should have with their clients in order to avoid liability. Following the decision in *Fleet*, the banks' role in both lending and taking security was undefined.[320] Giving financial assistance in a market of undeterminable liability became a frightening prospect for all financial organisations.[321]

Nevertheless, in spite of the 'deep pockets' argument, some believed that *Fleet Factors II* took the most environmentally favourable approach. The Eleventh Circuit court suggested how the *Fleet Factors* decision was made to, 'encourage creditors to investigate thoroughly…and…will encourage them to monitor the hazardous waste treatment systems.' [322] Certainly, *Fleet's* ruling made lenders more aware of the risks that can be incurred during their lending to borrowers with contaminated land. It was also one of the initial drivers for the introduction of environmental risk management in banks.

[317] ibid, 1557.
[318] ibid, 1556.
[319] Jarvis and Fordham (n 51) 16.
[320] ibid.
[321] ibid.
[322] *Fleet Factors* (n 296) 1557 – 1558.

I: So, if we move on to question seven now. Has the implementation of environmental regulation affected both lenders and borrowers?

R_5: Yes, I would say very strongly so and in the US we saw this in the early 70's with the Clean Air and the Clean Water Act, and then we saw it again with Superfund and Industrial Site Recovery Act (ISRA) and then obviously the phase 1's where there was not only an awareness of the environmental issues, but a requirement that the documentation be prepared. [323]

Fleet also showed how the strict application of lender liability for environmental damage can be problematic. Lenders have an 'emerging role' in strengthening environmental law and policy.[324] In hindsight, it is apparent that the decision in *Fleet Factors II* was not good for *sustainable development* or the remediation of polluted land. Essentially, the ruling in *Fleet Factors II* created a fear to lend; and banks became uncertain as to the relationship that they should have with their borrowers.[325]

C. The Secured Creditor Exemption Following the Decision in *Fleet Factors*

The case of *In re Bergsoe Metal Corp* 910 F 2d 668 (9th Cir 1990) challenged the decision in *Fleet*.[326] In *Bergsoe*, the court held that 'participates in the management' means 'actual participation',[327] and rejected the 'capacity to influence test' outlined in

[323] Interview with Respondent 5.
[324] BJ Richardson, *Environmental Regulation through Financial Organisations* (Kluwer Law International 2002) 3.
[325] Jarvis and Fordham (n 51) 16.
[326] *In re Bergsoe Metal Corp* 910 F 2d 668 (9th Cir 1990).
[327] ibid, 672.

Fleet.[328] The problem with *Bergsoe*, however, was that it did not clearly outline the types of activities that are, and are not, covered by the secured creditor exemption.[329] So, although *Bergsoe* marked a return to the reasoning in *Mirabile*, the matter of the exemption's application still remained unresolved.[330] However, in 1992, the US EPA created *The Lender Liability Rules*[331] to remove the ambiguity surrounding the exemption. The Rules sought to give advice to lenders on the liability criteria within CERCLA.[332] However, uncertainty established itself once again as the Rules were rejected in the case of *Kelley v Environmental Protection Agency* (1994) 15 F 3d 1100 (DC Cir 1994).[333] In the case of *Kelley*, the court ruled that the US EPA, which created a regulation (the Lender Liability Rules) that limited lender liability under CERCLA, lacked the 'statutory authority to restrict by regulation private rights of action arising under the statute.'[334] In Alvarez's opinion, the decision in *Kelley* made CERCLA appear as, 'a giant bear of environmental regulation', which was, both, 'clumsy and inefficient.'[335]

Two years after the ruling in *Kelley*, CERCLA was amended by the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act 1996, Pub L No 104-208, 110 Stat 3009-462.[336] This is also known as the 'Lender Liability Act 1996'. The Lender Liability Act introduced reforms that aimed to clarify the scope of the secured creditor exemption following the decision in *Fleet Factors II.* For example, the Act of 1996

[328] ibid.
[329] Cobb (n 273) 262.
[330] ibid.
[331] CERCLA 57 Fed Reg 18,344 (29 April 1992).
[332] Ahrens and Langer (n 65) 482.
[333] *Kelley v Environmental Protection Agency* (1994) 15 F 3d 1100 (DC Cir 1994).
[334] ibid, 1100.
[335] Alvarez (n 286) 465.
[336] Asset Conservation, Lender Liability, and Deposit Insurance Protection Act 1996, Pub L No 104-208, 110 Stat 3009-462.

revoked the 'capacity to influence' test at 42 U.S.C. section 9601(20)(F)(i)(II).[337] With regards to liability as an 'owner or operator', the 1996 Reforms stated that, 'The term "owner or operator" does not include a person that is a lender that, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect the security interest of the person in the vessel or facility.'[338] And pursuant to section 9601(20)(E), '…"owner or operator" does not include a person that is a lender[339] that did not participate in management of a vessel or facility prior to foreclosure.'[340] The 1996 amendments established clearer boundaries for activities that do, and do not, include 'participates in management'.[341] According to 42 U.S.C. section 9601(20)(F)(iii), 'performing an act or failing to act prior to the time at which a security interest is created in a vessel or facility' is not 'participating in management'.[342] Sometimes a lender is unable to rely on the protection of the secured creditor exemption. However, there is a limitation on liability for any person that can engage specific statutory defences under section 9607(b)[343] or is a 'bona fide prospective purchaser' of land.[344] It is true that the 1996 Reforms added a great deal more transparency to CERCLA's secured creditor exemption.[345] This is evidenced by the answer that one respondent, who currently works for a prestigious American investment

[337] See, 42 U.S.C. s 9601(20)(F)(i)(II). Section (F) expressly states that: 'For purposes of subparagraph (E)— (i) the term "participate in management" means—
(I) means actually participating in the management or operational affairs of a vessel or facility; and
(II) does not include merely having the capacity to influence, or the unexercised right to control, vessel or facility operations.'
[338] 42 U.S.C. s 9601(20)(E)(i).
[339] The term 'lender' is defined at 42 U.S.C. s 9601(20)(G)(iv.).
[340] ibid, s 9601(20)(F)(i)(1).
[341] ibid, s 9601(20)(F)(ii) and (iv).
[342] This provision protects lenders from incurring liability through their conduct of due diligence.
[343] 42 U.S.C. s9601, s 9607(B).
[344] ibid, s 9607(R).
[345] However, see the decision in the case of *United States v Fleet Factors Corp*, 821 F Supp 707, 720 (SDGa 1993) (Fleet III).

bank, gave in interview. When asked about the CERCLA regime, the respondent said that the threat of direct lender liability was:

> *R_5: Not as big as it was in the 80's! Only because, in the early 80's, it* [CERCLA] *was surfacing, cataloguing and identifying all of the sites and then going after the companies. So there was a flurry of legal activity going on towards these companies; there was a lot of fear amongst these companies… and rightly so… if they found a label with their name on it, they would be dragged into the litigation and that's exactly how they did it… right… because the whole point was that the government was going to pay up front for the clean-up and then go after the "potentially responsible parties" for recompense for that. Then it quietened down. There isn't much activity right now, as far as the initial identification and lawsuit; but there is a lot of money being paid by companies to remediate. Although some of these sites will take decades to clean-up, and some of them are quite public and quite well known.*[346]

Now that the US's experience of lender liability for historic contaminated land has been discussed, the next section analyses the position in the UK. This analysis focuses upon the contaminated land regime under Part IIA of the EPA 1990.

[346] Interview with Respondent 5.

II. Historic Land Contamination in the United Kingdom

A. Introduction

The UK's industrial revolution began in the latter part of the eighteenth century. While the burgeoning heavy industry created economic prosperity and infrastructural improvements, it also led to a dangerous amount of pollution to reside in many areas of the UK. Even today, these previously industrialised spaces still pose a risk to human health and affect the environment, etc.[347] However, the amount of land affected by contamination is currently uncertain. For the purpose of this thesis 'land affected by contamination' shall refer to any land that has not yet been identified by the contaminated land regime, is in the process of remediation or cannot be determined under Part IIA's definition and risk-based assessment. Alternatively, 'contaminated land' refers to any land that has already been determined by the contaminated land regime. In a 2002 Environment Agency (EA) Report it was estimated that around 100,000 sites may have been impacted by previous industrial activities.[348] On the other hand, a more recent 2009 Report states that there could be c. 325,000 sites (or 300,000 hectares of land) of potentially contaminated land situated throughout the UK.[349]

So, what has been done to remediate such a problematic heritage? Initially, the UK relied upon the common law, and a number of statutory regimes, to deal with any contaminating substances that were present within land.[350] The singular use of the existing legal framework was a questionable method for dealing with the legacy

[347] See, *The Claimants appearing on the Register of the Corby Group Litigation v Corby District Council* [2009] EWHC 1944 (TCC).
[348] Environment Agency, *Dealing with contaminated land in England - Progress in 2002 with implementing the Part IIA regime* (EA, 2002) 2.
[349] Environment Agency, *Reporting the Evidence* (n 16) 26.
[350] infra, ch 3.

problem.[351] Consequently, the government at the time proposed that a regulatory regime was needed in order to enforce the identification and remediation of contaminated land.

The initial idea was to create a system that would publicly register contaminated sites under section 143 of the EPA 1990. However, in 1993, the then Secretary of State (Michael Howard) rejected this proposal.[352] After the publication of the influential consultation paper, *Paying for Our Past* (1994),[353] Part IIA was inserted into the EPA 1990 by virtue of section 57 of the Environment Act (EA) 1995.[354] Part IIA brought into force the contaminated land regime[355] for England.[356] Part IIA was based on a statutory nuisance model and provided a definition for 'contaminated land'.[357] The impact of Part IIA's enactment within the financial sector was quite substantial. The UK's lending community came to realise that this legislation may present a liability risk to both themselves and their clients. Upon Part IIA's implementation, lending institutions were concerned that they would be made liable, because they were considered to have 'deep pockets' and could afford to pay for large remediation costs. The general consensus was that the US's experiences with lender liability under CERCLA might become a reality in Britain.[358] The next section provides an overview of the UK's contaminated land regime. It gives a detailed analysis of the contaminated

[351] cf P Cane, 'Are Environmental Harms Special?' (2001) 13 Journal of Environmental Law 1.
[352] C Smith, 'Contaminated land: House of Commons Select Committee – Second Report' (1997) 61 SPEL 54-56; and S Chakravorty, 'Commercial aspects of section 143 of the Environmental Protection Act 1990' (1992) Jul JPL 624.
[353] Department for the Environment, *Paying for Our Past* (DoE, 1994).
[354] Environment Act 1995, s 57.
[355] For the purposes of this thesis, 'the contaminated land regime' refers to system for identifying and remediation contaminated land.
[356] EPA 1990, s 78.
[357] ibid, s 78A(2).
[358] E James, 'An American werewolf in London: applying the lessons of Superfund to Great Britain' (1994) 19 Yale J Intl L 349.

land regime's objectives and structure, regulatory duties, liability, and remediation requirements.

B. The Contaminated Land Regime[359]

Part IIA is the environmental law that is most likely to create direct liability for lenders based in the UK. Hood states:

> 'The critical issue for a lender, in environmental matters, is the extent to which it will be liable for the costs of cleaning-up land which is found to be contaminated.' [360]

Given the nature and aims of this thesis, it is essential that Part IIA of the EPA 1990 is evaluated in detail. This will provide the necessary information for understanding the research findings. As discussed above, the Part IIA regime was implemented in order to deal with the United Kingdom's significant legacy of 'contaminated land'.[361] In theory, the regime hangs treacherously over mortgagees, like the sword that was placed above Damocles.[362] While suspended, it remains ready to deliver the fatal blow. In reality, however, the sword is blunt and incapable of much damage because of the regime's ineffective enforcement and complex structure. Part IIA's weaknesses can be attributed to the current Government's political agenda and the fact that the regime's primary regulators (i.e. the local authorities and the EA) are operating in an increasingly difficult economic environment. Consequently, the regulators have insufficient

[359] It is essential to point out that this thesis is discussing the contaminated land regime in England only.
[360] Hood (n 71) para 13.01.
[361] EPA 1990, s 78A(2).
[362] MT Cicero, *Tusculan Disputations* (AE Douglas ed, Aris & Phillips 1985).

resources to fulfil their statutory duties under Part IIA; and, as a result, determination figures under the Part IIA regime are at a remarkably low level. The following sections outline the contaminated land regime in greater detail.

1. The Overarching Objectives and Structure of Part IIA of the EPA 1990

Part IIA's objectives include:

- 'To identify and remove unacceptable risks to human health and the environment;

- To seek to ensure that contaminated land is made suitable for its current use; and

- To seek to ensure that the burdens faced by individuals, companies and society as a whole are proportionate, manageable and compatible with the principles of sustainable development.'[363]

The contaminated land regime is based on a 'tiered structure' of legislation.[364] The primary source of legislative authority – Part IIA – was introduced to create the goals and expectations of the regime. The regime's hierarchy is as follows: (1) Part IIA of the EPA 1990; (2) The Contaminated Land Regulations 2006 (amended); (3) the Department for Environment, Food and Rural Affairs' (Defra) Statutory Guidance; and

[363] Defra 2012 (n 21) para 1.4.
[364] Vaughan, 'Policy, Practice and Pollution' (n 19) 2-3. See also, L Etherington, 'Statutory Nuisance and 'Hybrid Orders': 'True Crime' Stories?' (2012) 33(3) Statute Law Review 390.

(4) the Environment Agency's (EA) Scientific and Technical Advice and Procedural Guides.[365] These sources are now considered individually.

1.1. Part IIA of the EPA 1990

Part IIA was inserted into the EPA 1990 by section 57 of the Environment Act 1995[366] and introduced the contaminated land regime into law. It is the statute that grants legal validity to the regime, setting out the intention and will of Parliament. Part IIA provides, amongst other things, a definition of contaminated land and summarises the statutory duties of the regulators.

1.2. The Contaminated Land Regulations ('the Regulations')

The Contaminated Land (England) Regulations 2006[367] (as amended by the Contaminated Land (England) (Amendment) Regulations 2012)[368] were passed to define the meaning of 'special sites'.[369] The Regulations also provide a framework for the content of 'remediation notices',[370] including the appeals' process that can be taken by the recipient of such a notice.[371]

[365] ibid.
[366] Environment Act 1995, s 57.
[367] The Contaminated Land Regulations 2006, SI 2006/1379.
[368] The Contaminated Land (England) Regulations 2012, SI 2006/1380. See also, The Contaminated Land (Wales) Regulations 2012, SI 2006/2989.
[369] EPA 1990, s 78C(3).
[370] ibid, s 78E(1).
[371] Contaminated Land (England and Wales) Regulations 2006, reg 4.

1.3. The Statutory Guidance ('the guidance')

The statutory guidance is an extremely important asset for the contaminated land regime. The guidance 'establishes a legal framework for dealing with contaminated land in England … [and] … is intended to explain how local authorities should implement the regime.'[372] It is therefore the source of 'fleshier' information that is relied upon by the regulators of the Part IIA regime. In 2012, Defra's contaminated land statutory guidance (Circular 01/2006)[373] was revised. This was done in an effort to refine the regime as a means of providing more clarity for the regulators.[374] As a result a number of cosmetic changes have been made, e.g. cutting size of the document down, putting it in a more readable format, separating radioactive contaminants into another document to avoid confusion and highlighting the aims of the regime up-front. Despite the revision, the guidance remains largely the same.[375] As well as cosmetic changes, a number of amendments have been made. For example, the term 'pollutant linkage' has now been changed to 'contaminant linkage'.[376] Also, the definition and assessment of 'significant harm'[377] and 'significant possibility of significant harm' (SPOSH)[378] have been modified. With regards to the pollution of controlled waters, the earlier threshold for water was 'any pollution of water', and now the threshold has been changed to the 'significant pollution of controlled waters', or a 'significant possibility of significant pollution of controlled waters'.[379] It will be interesting to see how the recent changes will affect the regime's operation in the future. Raising the threshold for the pollution

[372] Defra 2012 (n 21) para 1.
[373] See, Department for Environment, Food and Rural Affairs, *Circular 01/2006 Environmental Protection Act 1990: Part 2A – Contaminated Land* (Defra, 2006).
[374] Defra 2012 (n 21) para 2.
[375] For a good discussion of the recent changes see, Fogleman, 'The new statutory guidance' (n 23) 47.
[376] Defra 2012 (n 21) para 3.8.
[377] ibid, para 4.9.
[378] ibid.
[379] ibid, paras 4.34 - 4.46.

of controlled waters may mean that it is more difficult to determine liability under Part IIA.

1.4. Scientific and Technical Advice and Procedural Guides

The contaminated land regime is also supplemented by scientific and technical advice and procedural guides. This information aids local authorities, expanding on the statutory guidance. A good example of such advice can be found in *The Contaminated Land Inspection Strategies - Technical Advice for Local Authorities* (2004),[380] which helps local authorities create and utilise inspection strategies to deal with contaminated land in their areas.

2. The Definition of 'Contaminated Land' and Regulatory Duties

2.1. The Definition of 'Contaminated Land'

Section 78A(2) of the EPA defines 'contaminated land' as:

> '… any land which appears to the local authority in whose area it is situated to be in such a condition, by reason of substances in, on or under the land, that;

a) significant harm is being caused or there is a significant possibility of such harm being caused; or

[380] Department for the Environment, Transport and the Regions and Environment Agency, *Contaminated Land Inspection Strategies: Technical Advice for Local Authorities* (DETR and EA, June 2004).

b) significant pollution of controlled waters is being caused or there is a significant possibility of such pollution being caused.'[381]

Lee has described the section 78A(2) definition as 'bare' with many of the central issues being 'spelled out in statutory guidance'.[382] Despite being 'bare', the section underlines a number of the most important points about the contaminated land regime. First, it describes how 'contaminated land' is different from land that is merely 'affected by contamination'. It is possible that significantly harmful substances[383] are present in, on or under land but do not pose a significant risk that is capable of determination under Part IIA. Secondly, in order for a substance to be considered as 'harmful', the harm must reach the threshold of being 'significant' in its effect upon the health of living organisms and/or an ecological system.[384] Finally, section 78A(2) shows that local authorities have a statutory duty to inspect its area for contamination. The specific duties of the local authorities are highlighted in the following section.

2.2. Inspection, Determination and Registration Duties

By virtue of section 78B(1) of the EPA:

> 'Every local authority shall cause its area to be inspected from time to time for the purpose of - (a) identifying contaminated land; and (b) of enabling

[381] EPA 1990, s 78A(2).
[382] Lee, 'New Environmental Liabilities' (n 29) 264.
[383] EPA 1990, s 78A(9): '… "substance" means any natural or artificial substance, whether in solid or liquid form or in the form of a gas or vapour.'
[384] ibid, s. 78A(4): 'harm to the health of living organisms or other interference with the ecological systems of which they form part and, in the case of man, includes harm to his property.'

> the authority to decide whether any such land is required to be designated as a special site.'[385]

Local authorities should take a strategic approach to the inspection of land.[386] The inspection should be rational, ordered and efficient in reflecting local circumstances[387] and prioritising the higher risk sites.[388] The guidance states that, to help identify and collect information about contaminated land in their areas, local authorities must prepare written inspection strategies,[389] which are to be kept under periodic review at least every five years.[390] In 2002, it was shown that ninety four per cent of the local authorities had created such a strategy.[391] By March 2007, 'all 375 local authorities' in England and Wales had a strategy in place.[392]

Under section 78C of the EPA 1990, the enforcing authority has a duty to identify and designate any special sites in its area.[393] Special sites are defined in section 78A(3) of the EPA as: 'Any contaminated land – (a) which has been designated as such by virtue of section 78C(7) or 78D(6); and (b) whose designation as such has not been terminated by the appropriate Agency under section 78Q(4).'[394] For the purposes of Part IIA, the 'appropriate Agency' refers to the Environment Agency (EA) in relation to England.[395] If land is a special site, the Agency may 'adopt' the remediation notice.[396] Before making the decision that a site is 'special', enforcing authorities may take the advice of

[385] EPA 1990, s 78B (1); Defra 2012 (n 21) para 2.1.
[386] ibid, para 2.3.
[387] ibid, paras 2.3 – 2.6.
[388] ibid, paras 2.7 – 2.8.
[389] ibid, para 2.4.
[390] ibid, para 2.5.
[391] Environment Agency, *Dealing with contaminated land in England* (n 348) 13.
[392] Environment Agency, *Reporting the Evidence* (n 16) 6.
[393] EPA 1990, s. 78C(1).
[394] ibid, s. 78A(3).
[395] ibid, s. 78A(9)(a).
[396] ibid, s 78Q(1).

the EA.[397] Equally, if the EA believes that a site requires designation as a special site, it will alert the local authority by notice and deal with the area accordingly.[398] If the local authority gives notice about a potential special site and the Agency declines to accept the notice, the decision may be referred to the Secretary of State who will decide the case on the facts presented by both parties.[399] The situations where referral to the EA should take place are listed at Regulation 2(1)(a)-(h). The list includes, *inter alia*:

- Land affecting controlled waters (further aided by Regulation 3 and Schedule 1).

- Land within a nuclear site.

- Land owned or occupied by or on behalf of the Secretary of State.[400]

The sites in the list are 'special' because the EA, and not the local authority, is deemed to possess the necessary expertise to deal with such sites. The EA's expertise is required since such sites could be a great deal more harmful than in ordinary circumstances. For example, land affecting a controlled water[401] source provides a pathway that may carry a contaminant and caused significant harm to a number of receptors.[402] Thus, it is

[397] ibid, s 78C(3).
[398] ibid, s 78C(4).
[399] ibid, s 78C(10).
[400] Contaminated Land (England and Wales) Regulations 2006 (as amended), reg 2.
[401] EPA 1990, s. 78F(9): '"controlled waters"— (a) in relation to England and Wales, has the same meaning as in Part III of the Water Resources Act 1991 except that "ground waters" does not include waters contained in underground strata but above the saturation zone; and (b) in relation to Scotland, has the same meaning as in section 30A of the Control of Pollution Act 1974.'
[402] Defra 2012 (n 21) para 4.

important that local authorities understand the definition of a special site and are able to identify and refer such sites to the appropriate Agency.

Pursuant to section 78E(1) of the EPA it is the duty of the enforcing authority to require remediation of contaminated land.[403] The authority must serve a 'remediation notice'[404] on each person who is an appropriate person to the contamination.[405] Regulation 4(2) suggests that, 'A remediation notice must explain —

a. That a person on whom it is served has a right of appeal against the notice under section 78L;

b. How, within what period and on what grounds an appeal may be made; and

c. That a notice is suspended, where an appeal is duly made, until the final determination or abandonment of the appeal.'[406]

The various grounds for appeal are outlined in Regulation 7(1)(a)-(s). However, even if a person has a ground for appeal, the Secretary of State (SoS) can dismiss an action that has no 'material value'.[407] Remediation under the contaminated land regime is further discussed later in the chapter.

Finally, local authorities must maintain a register containing information about contaminated land in their areas.[408] Such information can include the service of

[403] EPA 1990, s 78E.
[404] ibid, s 78E(1).
[405] Contaminated Land (England and Wales) Regulations 2006 (as amended), reg 4(2).
[406] ibid, reg 4(2)(a)-(c).
[407] ibid, reg 7(3).
[408] EPA 1990, s 78R.

remediation notices[409] and/or convictions under section 78M of the EPA.[410] The registers must be made readily available for any members of the public who wish to receive the information.[411] The information is made publicly accessible under the Environmental Information Regulations 2004,[412] and these are carved out of the Freedom of Information Act 2007[413] because of the need to ensure the effective transposition of the European Directive 2003/4/EC on Public Access to Environmental Information.[414] For the purposes of Part IIA, no information is to be contained in the register that impacts the interests of national security[415] or is regarded as confidential information.[416]

3. Risk Assessment

'Risk', according to the statutory guidance, means a combination of:

a) 'the likelihood that harm, or pollution of water, will occur as a result of contaminants in, on or under the land; and

b) the scale and seriousness of such harm or pollution if it did occur.'[417]

[409] ibid, s 78R(1)(a).
[410] ibid, s 78R(1)(k).
[411] ibid, s 78R(8)(a)-(b).
[412] Environmental Information Regulations 2004, SI 2004/3391.
[413] Freedom of Information Act 2007.
[414] Directive 2003/4/EC of the European Parliament and of the Council of 29 January 2003 on public access to environmental information and repealing Council Directive 90/313/EEC [2003] OJ L141/26.
[415] EPA 1990, s 78S.
[416] ibid, s 78T.
[417] Defra 2012 (n 21), para 3.1.

The local authority should consider the risk in relation to the 'current use' of the land.[418] In so doing, it should act in accordance with the guidance,[419] which suggests that, 'The local authority has the sole responsibility for determining whether any land appears to be contaminated land.'[420] The revised guidance only applies to non-radioactive contamination.[421] The 'four grounds of determination' are discussed below.

3.1. The Four Grounds of Determination

The statutory guidance outlines the four grounds for determination. [422] They include:

a) 'Significant harm is being caused to a human, or relevant non-human, receptor; or

b) There is a significant possibility of significant of such harm being caused to a human, or relevant non-human, receptor; or

c) Significant pollution of controlled waters is being caused; or

d) There is a significant possibility of such pollution being caused.'[423]

When making a determination that land is contaminated, there is now a presumption that the land is 'innocent until proven guilty'.[424] If a site is identified as contaminated

[418] ibid, para 3.5(a) – (e).
[419] EPA 1990, s 78A(2); Defra 2012 (n 21) para 5.1.
[420] Defra 2012 (n 21), paras 5.5 – 5.6.
[421] ibid, para 5.6.
[422] ibid, para 5.5.
[423] ibid, para 5.6.
[424] ibid, paras 5.2 – 5.4.

for the purposes of section 78A(1) and (2), a notice of such determination shall be given to: '(a) the appropriate Agency; (b) the owner of land; (c) any person who appears to the authority to be in occupation of the whole or any part of the land; and, (d) each person who appears to the authority to be an appropriate person.'[425]

Local authorities are now under a legal obligation to complete a 'risk summary' of any land that poses a risk within their area.[426] Before a site can be determined as contaminated, the authority must show that a 'risk of harm' exists. While the definition of 'risk' has been outlined above, 'harm' is defined by section 78A(4) of the EPA as, 'harm to the health of living organisms or other interference with the ecological systems of which they form part.'[427] A risk will be present when the local authority can prove that a 'pathway' exists between a 'contaminant' and a 'receptor'.[428] This chain of events is described by the guidance as a 'contaminant linkage'.[429] The guidance emphasises the need for the local authority to take a staged approach to this risk assessment.[430] It suggests that the current use of the land should be inspected with preliminary investigations first (e.g. a desk-based study).[431] There are also a number of technical and scientific guides that can be used in the preliminary assessment of the risk of harm (soil guideline values (SGVs), toxicology (TOX) reports, and generic assessment criteria (GACs), etc.). Following the preliminary risk assessment, if there is evidence

[425] EPA 1990, s78B(3)(a)-(d); Defra 2012 (n 21), para 5.14.
[426] ibid, paras 3.33 – 3.36.
[427] EPA 1990, s 78A(4).
[428] Defra 2012 (n 21) para 3.8: (a) 'A "contaminant" is a substance which is in, on or under the land and which has the potential to cause significant harm to a relevant receptor, or to cause significant pollution of controlled waters; (b) A "receptor" is something that could be adversely affected by a contaminant, for example a person, an organism, an ecosystem, property, or controlled waters; and, (c) a "pathway" is a route by which a receptor is or might be affected by contamination.'
[429] ibid, para 3.9.
[430] ibid, para 3.12.
[431] ibid, paras 3.5 - 3.7.

of contamination that poses an unacceptable risk, a more detailed inspection should be undertaken[432] (i.e. a Phase II Risk Assessment).

3.1.1. Significant Harm to Human Health

The classification of what harm should be identified as 'significant' is delegated by Part IIA for the statutory guidance to determine.[433] The guidance states that, 'In all cases the harm should be directly attributed to the effects of contaminants … on the body(ies) of the person(s) concerned.'[434] Local authorities' determinations of the existence of contaminated land should be based on the 'appropriate scientific and technical assessment of all the relevant evidence.'[435] Some health effects should always be considered to constitute significant harm, i.e.:[436]

> 'death; life threatening diseases (e.g. cancers); other diseases likely to have serious impacts on health; serious injury; birth defects; and impairment of reproductive functions.'[437]

Other effects may also be considered, but these are dependent upon the authority's determination.[438] They include:

> 'physical injury; gastrointestinal disturbances; respiratory tract effects; cardio-vascular effects; central nervous system effects; skin ailments;

[432] ibid, para 3.13.
[433] EPA 1990, s 78A(5).
[434] Defra 2012 (n 21), para 4.3.
[435] ibid, para 4.4.
[436] ibid, para 4.5.
[437] ibid.
[438] ibid.

effects on organs such as the liver or kidneys; or a wide range of other health impacts.'[439]

The 'seriousness of harm' should be considered by the authority in deciding significant harm. And the authority's consideration should include, 'the impact on the health and quality of life, of any person suffering the harm; and the scale of the harm.' [440] If harm is occurring and it is not significant, the guidance states that the authority should consider whether a SPOSH exists: 'For example, this might be the case if there is evidence that the harm may be a precursor to, or indicative or symptomatic of, a more serious form of harm, or that repeated episodes of minor harm (e.g. repeated skin ailments) might lead to more serious harm in the longer term.'[441]

3.1.2. Significant Possibility of Significant Harm to Human Health

The statutory guidance advises that before deciding whether or not a SPOSH exists, the local authority must first understand the 'possibility of significant harm' (POSH). POSH as it applies to human health means: 'the risk posed by one or more relevant contaminant linkage(s) relating to the land.'[442] It comprises:

'(a) The estimated likelihood that significant harm might occur to an identified receptor, taking account of the current use of the land in question;
(b) The estimated impact if the significant harm did occur i.e. the nature of

[439] ibid, para 4.6.
[440] ibid.
[441] ibid, para 4.7.
[442] ibid.

> the harm, the seriousness of the harm to any person who might suffer it, and (where relevant) the extent of the harm in terms of how many people might suffer it.' [443]

This decreases the likelihood of invalid risk assessment. This assessment can be based on 'the possible future risk if a more sensitive receptor moved onto to land'.[444] The timescale of the risk's manifestation must also be highlighted.[445] The local authority making the determination should use the statutory guidance's categorisation of SPOSH to human health.[446] There are four categories,[447] including:

Category 1	**Category 2**	**Category 3**	**Category 4**
Local authorities should assume that SPOSH exists if there is 'an unacceptably high probability, supported by robust science-based evidence that significant harm would occur if no action is taken to stop it.'[448] The statutory guidance emphasises the need for the enforcing authority to take into account similar cases during	Where 'there is a strong case for considering the risks from the land are of sufficient concern', land should be deemed as Category 2.[450] This may be the case even if there is no or little evidence to support the determination.[451] The local authority should act on a 'precautionary basis', including the	When there is not 'a strong case' of SPOSH as with Category 1, land should be determined as a Category 3 site. This categorisation includes land that is 'high risk', but Part IIA intervention is unnecessary.[453]	The guidance suggests that simply because land is considered low risk, the local authority should not assume that SPOSH does not exist.[454] An example of a Category 4 site is, amongst other things:[455] 'Land where no relevant contaminant linkage has been established.'[456]

[443] ibid, para 4.9. [at para. 4.11].
[444] ibid, para 4.13.
[445] ibid, para 4.14.
[446] ibid, para 4.17.
[447] ibid, paras 4.19 – 4.25.
[448] ibid, 4.19.
[450] ibid, para 4.25(a).
[451] ibid.
[453] ibid, para 4.25(b).
[454] ibid, para 4.21.
[455] ibid, para 4.21(a)-(d).
[456] ibid, para 4.21(a).

their risk assessment.[449]	opinions of experts.[452]		

This categorisation may be theoretically feasible but practically problematic, because local authorities are likely to find it difficult to distinguish between Categories 2 and 3.[457] However, the guidance provides local authorities with advice when deciding whether land falls into Category 2 or Category 3.[458] If the local authority is still undecided, it should place the land into Category 3.[459]

3.1.3. Significant Harm and Significant Possibility of Significant Harm to Non-human receptors

When determining harm to non-human receptors, local authorities are advised to refer to Tables 1 and 2 of the statutory guidance.[460] According to the guidance 'non-human receptors'[461] include 'ecological system effects' and 'property effects'.[462] Ecological system effects concerns 'any ecological system, or living organism forming part of such a system.'[463] For example, a site of special scientific interest would be considered a relevant receptor.[464] Significant harm to an ecological system would include, etc., 'harm which results in an irreversible adverse change… in the functioning of the ecological system'.[465] SPOSH to ecological systems includes, *inter alia*, 'significant

[449] ibid.
[452] ibid.
[457] ibid.
[458] ibid, paras 4.26 – 4.28.
[459] ibid, para 4.29.
[460] ibid, para 4.30.
[461] ibid.
[462] ibid, sec 4.3 (Tables 1 and 2).
[463] ibid, sec 4.3 (Table 1) 24.
[464] ibid.
[465] ibid.

harm of that description is more likely than not to result from the contaminant linkage in question'.[466]

The other non-human receptor under the regime is 'property'.[467] The first form of property listed in Table 2 can be in the form of crops, livestock, wild animals subject to shooting or fishing rights etc.[468] An example of harm that is considered significant is, 'For crops, a substantial diminution in yield or other substantial loss in their value resulting from death, disease or other physical damage.'[469] SPOSH to this form of receptor is determined, 'where the local authority considers that significant harm is more likely than not to result from the contaminant linkage in question, taking into account the relevant information for that type of contaminant linkage, particularly in relation to the ecotoxicological effects of the contaminant.'[470] The second form of property can be in the form of buildings. Table 2 states that, 'For this purpose, "building" means any structure or erection, and any part of a building including any part below ground level, but does not include plant or machinery comprised in a building, or buried services such as sewers, water pipes or electricity cables.'[471] In this case 'structural damage, substantial damage or substantial interference' are considered, amongst others, to be forms of significant harm. SPOSH to buildings is similar to SPOSH to the first form of property.[472] However, instead of assessing the ecotoxicological effects, the local authority must take into account '… the expected

[466] ibid.
[467] ibid, sec 4.3 (Table 2).
[468] ibid.
[469] ibid.
[470] ibid.
[471] ibid.
[472] ibid.

economic life of the building (or in the case of a scheduled Ancient Monument the foreseeable future).'[473]

3.1.4. Significant pollution of controlled waters is being caused

The publication of the new guidance coincided with the bringing into force of section 86 of the Water Act (WA) 2003[474] (see, 'the Water Act 2003 (Commencement No 11) Order 2012').[475] When brought into force section 86 of the WA 2003 subsequently amended the definition of 'contaminated land'.[476] As a result of section 86, the pollution of controlled waters must be 'significant' before appropriate persons can be determined.[477] The test for determining this is, 'the entry into controlled waters of any poisonous, noxious or polluting matter or any solid waste matter; or that they have already entered the waters and are likely to do so again.'[478] An example that the statutory guidance gives of a 'significant pollution of controlled waters' is any pollution that is equivalent to 'environmental damage'[479] under the Environmental Damage (Prevention and Remediation) Regulations 2009.[480]

3.1.5. Significant possibility of significant pollution of controlled waters

The significant possibility of significant pollution of controlled waters is defined as 'the estimated likelihood that significant pollution of controlled waters might occur.'[481] The

[473] ibid.
[474] Water Act 2003.
[475] Water Act 2003 (Commencement No. 11) Order 2012.
[476] Water Act 2003, s 86.
[477] Defra 2012 (n 21), para 5.6(c).
[478] ibid, para 4.41(a) – (c).
[479] Environmental Damage (Prevention and Remediation) Regulations 2009, SI 2009/153, reg 4.
[480] Defra 2012 (n 21) para 4.38(a). See also, 4.38(b) – (d).
[481] ibid, para 4.43.

local authority is advised by the guidance to understand whether the 'possibility of significant pollution of controlled waters' might occur. Following this, the significant possibility of significant pollution of controlled waters is assessed through a 'positive legal test'.[482] Paragraph 4.44 of the guidance states, '… the test the authority needs reasonable to believe that there is a significant possibility of such pollution, rather than to demonstrate that there is not.'[483] As with SPOSH, there are four categories, ranging from a Category 1 site to a Category 4 site.[484] They are outlined in a boxed table below.

Category 1	**Category 2**	**Category 3**	**Category 4**
This category covers the situation where there is 'a strong and compelling case' that the significant pollution of controlled waters exists.[485]	Land is placed into this category where 'the strength of the evidence' does not suggest a Category 1 site,[486] but the risks are of a sufficient concern on the basis of 'available scientific and expert evidence'.[487] The local authority should act on a 'precautionary basis'.[488]	Sites that do not meet the tests for Categories 1 and 2,[489] and where regulatory intervention is 'not warranted',[490] fall into this category.	In this case the land presents either no risk or the level of risk would be considerably low[491] (e.g. no contaminant linkage has been established).[492]

[482] ibid, para 4.44.
[483] ibid.
[484] ibid, para 4.46(a) – (d).
[485] ibid, para 4.46(a).
[486] ibid, para 4.46(b)(i).
[487] ibid, para 4.46(b)(ii).
[488] ibid.
[489] ibid, para 4.46(c).
[490] ibid.
[491] ibid.
[492] ibid, para 4.46(d).

The next section evaluates the types, and triggers, of liability that may be incurred under Part IIA of the EPA 1990.

4. Liability

Like CERCLA, liability under the contaminated land regime is strict and retrospective. Section 78F of the EPA enforces Part IIA liability. A bank with a significant degree of control over or possession of contaminated land is capable of incurring liability for the remediation costs as an 'appropriate person'. According to section 78F(9) of the EPA, an appropriate person is the person who must, 'bear responsibility for anything which is to be done by way of remediation in any particular case.'[493] Liability is to be allocated by the local authority to any appropriate persons associated with the contaminated land.[494] There are two classifications of appropriate persons.[495] First, section 78F(2) of the EPA suggests that liability will be allocated to:

> ' … any person, or any of the persons, who caused or knowingly permitted the substances, or any of the substances, by reason of which the contaminated land in question is such land to be in, on or under that land is an appropriate person.' [496]

The statutory guidance describes this as 'Class A' liability.[497] Secondly, section 78F(4) of the EPA states that:

[493] EPA 1990, s 78A(9).
[494] ibid, s 78F(1).
[495] ibid, s 78F; Defra 2012 (n 21) sec 7.
[496] ibid, s. 78F(2).
[497] Defra 2012 (n 21) para 7.3(a).

> 'If no person has, after reasonable inquiry, been found who is by virtue of subsection (2) above an appropriate person to bear responsibility for the things which are to be done by way of remediation, the owner or occupier for the time being of the contaminated land in question is an appropriate person.'[498]

The second type of person to bear responsibility for remediation is described as a 'Class B' appropriate person.[499] It is important to note that the 'Class A' and 'Class B' categorisations are not in any provision of Part IIA itself; such terminology is a product of the statutory guidance. The two types of liability will now be presented in more detail below.

4.1. Class A Liability

The phrase 'to cause or knowingly permit' is widely used in environmental law.[500] It can be found governing offences relating to the pollution of controlled waters contrary to an environmental permit made in accordance with the Environmental Permitting (England and Wales) Regulations 2010 (as amended)[501] etc. Despite the extensive use of the phrase 'to cause or knowingly permit', there is still a great deal of 'uncertainty' surrounding its meaning.[502] Although there is little judicial comment on how the trigger terms apply to Part IIA, previous cases concerning water pollution offences[503] can

[498] EPA 1990, s 78F(4).
[499] Defra 2012 (n 21) para 7.3(a).
[500] Lawrence and Lee 'Permitting Uncertainty' (n 31) 261-263. See also, Egede and Lee (n 56) 875.
[501] Environmental Permitting (England and Wales) Regulations 2010, SI 2010/675, regs 38(1) and 12(1). See also, N Parpworth, 'Who may be liable for an offence contrary to s. 85 for the Water Resources Act 1991? (2009) JPL 294. In is noteworthy that in section 33(1)(a) of the EPA 1990 it is 'knowingly cause'.
[502] Lawrence and Lee 'Permitting Uncertainty' (n 31) 261.
[503] Water Resources Act 1991, s 85; and Rivers (Prevention of Pollution) Act 1951, s 2(1).

nevertheless be relied upon to help define the use of the triggers in the environmental context.

4.1.1. 'Causes' Pollution

In *Alphacell v Woodward* [1972] AC 824[504] Lord Wilberforce gave his interpretation of 'to cause or knowingly permit' environmental pollution,[505] stating:

> '*causing*, which must involve some active operation or chain of operations involving as the result the pollution of the stream; *knowingly permitting*, which involves a failure to prevent the pollution, which failure, however, must be accompanied by knowledge.'[506]

Lord Salmon also suggested in *Alphacell* that the test for determining the offence of 'causing' pollution 'is essentially a practical question of fact which can best be answered by ordinary common sense'.[507] Liability for 'causing' is determined by a 'positive act',[508] which does not need to be the 'immediate cause' of the pollution[509] and is to be applied strictly.[510] While it is unlikely that a bank would be found liable for 'causing' pollution,[511] such lender liability may be possible where a bank has a

[504] *Alphacell Ltd v Woodward* [1972] AC 824.
[505] ibid, 834 (Lord Wilberforce).
[506] ibid.
[507] ibid 847 (Lord Salmon). See also, *Alphacell* (n 504) 834 (Lord Wilberforce).
[508] cf *Price v Cromack* [1975] 1 WLR 988; and *Wychavon District Council v National Rivers Authority* [1993] 1 WLR 125 with *National Rivers Authority v Yorkshire Water Services Ltd* [1995] 1 AC 444.
[509] *Environment Agency (formerly National Rivers Authority) v Empress Cars Co.* (1999) 2 AC 22, 28 (Lord Hoffman). See also, *Attorney-General's Reference (No. 1 of 1994)* [1995] 1 W.L.R. 599, 615 (Lord Taylor of Gosforth C.J.).
[510] *Alphacell* (n 504) 824; *R (ota of Crest Nicholson Residential Ltd) v Secretary of State for Environment, Food and Rural Affairs* (2010) EWHC 561(Admin).
[511] Egede and Lee (n 56) 876.

significant participation in a borrower's affairs e.g. as a 'non-executive director' or a 'shadow director'.[512]

4.1.2. 'Knowingly Permits' Pollution

Following Lord Wilberforce in *Alphacell*, the term 'knowingly permits' refers to a person with knowledge and a position of control failing to prevent pollution from occurring.[513] 'Causing' is a strict liability offence and does not require the proof of a defendant's knowledge of the illegal act. In order to secure a conviction for 'knowingly permitting' pollution, the prosecution must prove the defendant's *mens rea*.[514] This has been determined within the area of the criminal law that concerns the unlawful possession and transportation of drugs and other dangerous substances.[515] In *R v Hussain* [1969] 2 QB 567 a merchant shipman was charged with being knowingly involved in a fraudulent evasion of the prohibition of the importation of cannabis, contrary to section 304(b) of the Customs and Excise Act 1952.[516] Widgery LJ held that the word 'knowingly' for the purposes of section 304(b) concerned knowing that a fraudulent evasion in respect of goods is taking place, and that 'it is sufficient to justify conviction, even if he does not know precisely what goods are being imported.'[517] In the case of *Westminster County Council v Croyalgrange Ltd and Another* [1986] 1 WLR 674 the court ruled that the word knowingly was a 'necessary ingredient' of the

[512] See, *In re a Company No 00996 of 1979* (1980) Ch 138; and *Hydrodam (Corby) Ltd, Re, The Times*, Feb 19, 1992. cf *Tridos Bank NV v Dobbs* [2004] EWHC 845 (Ch).
[513] *Alphacell (*n 504) 834 (Lord Wilberforce).
[514] EA Martin (ed), *Oxford Dictionary of Law* (4th edn, OUP 1997) 290: 'mens rea [Latin: a guilty mind] The state of mind that the prosecution must prove a defendant to have had at the time of committing the crime in order to secure a conviction.'
[515] *Regina v Hussain* [1969] 2 QB 567. See also, *Regina v Ellis & Street* (1987) 84 Cr App R 235; and *Regina v Hullam* [1957] 1 QB 569.
[516] *Regina v Hussain* (n 509) 570D (Widgery LJ).
[517] ibid, 572A-B.

offence of using any premises as a sex establishment contrary to Schedule 3, paragraph 20(a) of the Local Government (Miscellaneous Provisions) Act 1982.[518] Thus, in *Croyalgrange's* case 'knowledge' constitutes 'actual knowledge' of the offence. The meaning of 'knowledge' was considered within the environmental context in the case of *Ashcroft v Cambro Waste Products Ltd* [1981] 1 WLR 1349.[519] *Ashcroft* concerned a deposit of waste in breach of a waste licence made pursuant to section 3 of the Control of Pollution Act 1973.[520] The court in *Ashcroft* ruled that, while it was necessary for the prosecution to show that the deposit had been 'knowingly permitted', proof of knowledge of the breach of condition was unnecessary.[521] *Ashcroft's* interpretation of 'knowingly permitted' was applied to unlawful deposits of waste contrary to section 33 of the EPA 1990 in *Shanks & McEwan (Teesside) Ltd v Environment Agency* [1999] QB 333,[522] and recently considered in the case of *Walker & Son (Hauliers) Ltd v Environment Agency* [2014] EWCA Crim 100.[523] In *Walker & Son*, the court had to determine the meaning of 'knowingly permits' under Regulation 38(1) of the Environmental Permitting (England and Wales) Regulations 2007,[524] ruling that knowledge of a breach of condition was not required under the Regulations.[525]

The case of *Circular Facilities (London) Ltd v Sevenoaks District Council* [2005] EWHC 865 assessed the term 'knowingly permitted' in relation to section 78F(9) of the EPA. *Circular Facilities* deals specifically with the meaning of 'knowledge' for the

[518] ibid, 683 (Lord Bridge of Harwich).
[519] *Ashcroft v Cambro Waste Products Ltd* [1981] 1 WLR 1349.
[520] ibid.
[521] ibid, 1355 (Boreham J). cf *Westminster CC v Croyalgrange* [1986] 1 WLR 674.
[522] *Shanks & McEwan (Teesside) Ltd v Environment Agency* [1999] QB 333 (Mance J).
[523] *Walker & Son (Hauliers) Ltd v Environment Agency* [2014] EWCA Crim 100.
[524] ibid, para 1.
[525] ibid, para 26.

purposes of section 78F of the EPA 1990. However, it is unnecessary to outline this case here, as this chapter returns to it below.[526]

The trigger term 'knowingly permitted' is a lender liability risk for UK banks.[527] This is because lenders are capable of collecting the necessary 'knowledge' of the contamination during their pre- and post-loan due diligence.[528] For example, Egede and Lee state that, 'It may be sufficient that a bank has available to it considerable elements of control in the covenants of a loan agreement, and is armed with the knowledge of environmental shortfalls on the part of the borrower company.'[529] Now the trigger terms under Part IIA have been evaluated, three of the most significant cases surrounding Class A liability are discussed.

4.1.3. Judicial Interpretation of Class A Liability under Part IIA

Part IIA of the EPA has generated only a limited number of cases concerning its application and operation. Nevertheless, there are three primary cases that are necessary to analyse. The section begins with *Circular Facilities (London) Ltd v Sevenoaks District Council* [2005] EWHC 865.

4.1.3.1. Circular Facilities (London) Ltd v Sevenoaks District Council

In the case of *Circular Facilities v Sevenoaks District Council* [530] the High Court evaluated an appeal to a remediation notice issued under Part IIA of the EPA 1990. The

[526] See overleaf.
[527] Egede and Lee (n 56) 877.
[528] ibid.
[529] ibid.
[530] *Circular Facilities v Sevenoaks District Council* [2005] EWHC 865 (Admin).

case concerned contamination on the site of former brickworks. The facts state that in February 1965 Mr Kinchen−Goldsmith, the owner of the site in question, was granted planning permission to infill clay pits with inert material e.g. "builders' rubble".[531] Kinchen–Goldsmith was granted permission for development in August 1977;[532] but this was transferred to a Mr and Mrs Scott in 1978.[533] On 7 July 1978 the site was investigated and five trial pits were dug by JCB digger to a level of 3.2 metres.[534] The findings of the investigation were reported on 14 July 1978.[535] The results of the soil investigation report showed that all of the pits had, as well as the inert fill material, 'black organic matter' held within them.[536] Pit 3 also had 'water entering excavation at this level and gases bubbling through it.'[537] In February 1978 Mr Scott made a further planning application.[538] The investigation report recommended that 'piled foundations' were needed on the land.[539] A company called Frankipile Ltd was tendered to install seventy-two piles at the site.[540] However, on 12 November 1979 the land was transferred to Circular Facilities Ltd (CFL).[541] In March 1980 Frankipile and the Council's building control officer were on the site to inspect the 'sinking piles and the adequacy of the foundations.'[542] CFL gave the soil investigation report to the building control officer.[543] In April 1980 the piling for the houses began[544] and the last house sold in 1985.[545] Despite selling the land, Mr Scott continued to have an active role in

[531] ibid, para 8 (Mr Justice Newman).
[532] ibid.
[533] ibid.
[534] ibid, para 9.
[535] ibid.
[536] ibid.
[537] ibid.
[538] ibid, para 10.
[539] ibid, para 11.
[540] ibid, para 12.
[541] ibid, para 13.
[542] ibid.
[543] ibid.
[544] ibid, para 14.
[545] ibid, para 15.

the development process.[546] The Council believed that CFL knowingly permitted there to be a substance contrary to section 78F(9) of the EPA, since 'the presence of the organic material had given rise to the presence of gases as a result of a chemical reaction or biological process'.[547] Newman J stated that:

> 'The difficulties to which this case gave rise relate not so much to questions arising in connection with the legislation, but with the difficulties of establishing facts, capable of giving rise to a conclusion that the requisite knowledge was held by CFL, at a date some twenty years prior to it being determined that the land was contaminated. A particular evidential difficulty arose because Mr Scott is dead.'[548]

In the Magistrates' hearing[549] the district judge ruled that exclusion test 6 of the statutory guidance excluded Mr Scott and the previous land owner from Class A liability.[550] The guidance allows exemption from Class A liability for those who would otherwise be liable, 'solely because of the subsequent introduction by others of the relevant pathways or receptors (as defined in Section 3) in the significant contaminant linkage.'[551] Ross states that, 'The judge had no doubts about what this guidance implied. Mr Scott and the previous landowner had both allowed tipping on the site, but were excluded from liability by test 6. It was Circular Facilities which had introduced the pathways and receptors to create the pollutant linkage, and as such it was the

[546] ibid, para 19.
[547] ibid, para 16.
[548] ibid, para 18.
[549] ibid. This case is unreported.
[550] K Ross, 'Contaminated land – where are we now?' (2007) 52(9) *JLSS* 52, 53.
[551] Defra 2012 (n 21) para 7.57.

appropriate person under s 78F.'[552] On appeal Newman J had to determine, *inter alia*, whether CFL could have been said to have knowledge of the contamination. In his judgment he held that: 'there is no basis for limiting the ambit of the section to exclude responsibility to those who do not know of the potentiality for the chemical reaction or biological process… The knowledge of the substance is taken to be the knowledge of the substance generated by the process.'[553]

This case demonstrates how severely Part IIA's liability can be applied. It shows how the thread holding the sword of liability is susceptible to change and may not always remain as strong as it is today. *Circular Facilities* shows that acquiring too much knowledge (whether expressed or implied) when undertaking environmental due diligence, may result in Class A liability as an appropriate person under section 78F of the EPA. However, lenders are excluded from Class A liability under Exclusion Test 1 of the statutory guidance.[554] This test excludes a person that provides financial assistance from incurring liability for causing or knowingly permitting contamination.[555]

4.1.3.2. R (on the application of Crest Nicholson Residential Ltd) v Secretary of State for Environment, Food and Rural Affairs

In *R (on the application of Crest Nicholson Residential Ltd) v Secretary of State for Environment, Food and Rural Affairs* [2010] EWHC 561 (Admin)[556] Crest Nicholson Residential Ltd (CN) applied under section 78L of the EPA 1990 to bring judicial

[552] Ross (n 550) 53.
[553] *Circular Facilities* (n 530), para 43.
[554] Defra 2012 (n 21) para 7.38.
[555] ibid.
[556] *Crest Nicholson* (n 510). This is also known as 'the Sandridge' case.

review proceedings to challenge a remediation notice making it the appropriate person to bear remedial costs for contaminated land.[557] Section 78L of the EPA 1990 states that, 'A person on whom a remediation notice is served may, within the period of twenty-one days beginning with the day on which the notice is served, appeal against the notice.'[558] The notice was issued on 22 July 2009[559] by the Secretary of State[560] and related to contamination identified at the site of St Leonard's Court, Sandridge, Hertfordshire.[561] It outlined the 'assessment actions' and 'interim remedial treatment actions' to be carried out by CN.[562] The land in question had bromide and bromate in the soil.[563] The substances also entered a local water course,[564] contaminating a chalk aquifer and affecting the business of Veolia Water Central Ltd (the local water supplier) and Thames Water Utilities Ltd (the local sewage company).[565] The facts state that 'from the 1950s to about 1980' the site was used by Redland Minerals Ltd (RM) for chemical production.[566] Work was carried out in buildings that were built upon 'hard standing' and 'sump holes' were used to collect the bromide and bromate 'generated by the chemical processes'.[567] In September 1983 RM sold the site to CN for development.[568] CN commenced 'some preliminary preparatory work on the Site' in 1984, demolishing the existing buildings and breaking up the hard standing.[569] Some

[557] ibid, para 1 (Mr Justice Sales).
[558] EPA 1990, s 78L(1).
[559] *Crest Nicholson* (n 510), para 1. The remediation notice was first issued in 2005 and was revised.
[560] ibid.
[561] ibid.
[562] ibid, para 3.
[563] ibid, para 2.
[564] ibid.
[565] ibid, para 3.
[566] ibid, para 4.
[567] ibid.
[568] ibid, para 5.
[569] ibid, para 6.

two and a half years later the development of St Leonard's Court began in 1986.[570] In his judgment Sales J says that:

> 'In that two-and-a-half year period the site was left exposed to the elements. The removal of buildings and broken up hard standing meant that rain had a greater effect in washing the bromide and bromate down into the soil than would otherwise have been the case.'[571]

In 1986 CN excavated the land, finding vague traces of bromide in the soil and water table.[572] However, the levels of this chemical appeared to be in small quantities at the shallow depth inspected (1 – 1.5 metres).[573] The remediation works undertaken by CN were 'too shallow'[574] and allowed the bromide and bromate to leach into the ground water. The residential area of St. Leonard's Court is in fact sitting on top of 'the largest groundwater contamination plume in Europe.' [575] CN sold the land in 1987.[576] The case was referred to the EA as a 'special site' in 2002 under section 78E of the EPA.[577] In 2005 a remediation notice was served identifying RM and CN as appropriate persons.[578] RM and CN used their section 78L right to appeal the decision of the Secretary of State,[579] who referred the matter to a planning inspector 'to hold an inquiry and report'.[580] The significance of this case lies in the fact that the inspector and Secretary

[570] ibid.
[571] ibid, para 7
[572] ibid, para 8.
[573] ibid.
[574] ibid, para 8.
[575] S Sykes, 'Groundwater Pollution Appeal: Major polluted site - Part IIA appeal' (*Eric-group*, 4 January 2010) <http://www.eric-group.co.uk/environmental_regulation_story.php?content_id=154> accessed 17 June 2013.
[576] *Crest Nicholson* (n 510) para 10.
[577] ibid, 14.
[578] ibid, 17.
[579] EPA 1990, s 78L(1).
[580] *Crest Nicholson* (n 510), para 18.

of State found CN and RM jointly liable for the contamination plume.[581] Remediation liability was allocated by the Secretary of State as follows: (1) bromate pollution – eighty five per cent to RM and fifteen per cent to CN; and (2) bromide pollution – forty five per cent to RM and fifty five per cent to CN.[582] Sales J upheld the inspector's report and dismissed the appeal for permission.[583]

It is important that lenders consider the decision in *Crest*, since it shows that the contaminated land regime is retrospective (i.e. the pollution occurred before the regulatory regime was brought into force but still fell under the regulatory regime). Importantly, RM had acquired the company which had originally operated the site. However, they had quit the site by the time of the acquisition. This case also shows the limits of 'Exclusion Test 3' (i.e. the 'Sold with Information' test),[584] as the Secretary of State held that it did not apply to RM's case.

4.1.3.3. R (on the application of National Grid Gas plc (formerly Transco plc)) v Environment Agency

R (on the application of National Grid Gas plc (formerly Transco plc)) v Environment Agency [2007] UKHL 30 concerned whether Class A liability under section 78F of the EPA is directly transferable to statutory successors-in-title. The successor-in-title in this case was National Grid Gas plc (Forbes J referred to it by its previous name, Transco).[585] The facts state that the EA had remediated a site at Bawtry, Doncaster.[586]

[581] Sykes, 'Groundwater Pollution Appeal: Major polluted site' (n 575).
[582] ibid
[583] *Crest Nicholson* (n 510), para 33.
[584] infra, pg 113.
[585] *R (on the application of National Grid Gas plc (formerly Transco plc)) v Environment Agency* [2006] EWHC 1083 (Admin) para 1 (Forbes J).
[586] *R (on the application of National Grid Gas plc (formerly Transco plc)) v Environment Agency* [2007] UKHL 23 1728F (Lord Scott of Foscote).

The site was first developed and operated on by the Bawtry and District Gas Company (B&DGC) from 1912 until 1 January 1931, when it amalgamated with the South Yorkshire & Derbyshire Gas Company (SY&DGC).[587] In 1948 ownership of the site was transferred to the East Midlands Gas Board (EMGB) as a consequence of the nationalisation of the gas industry.[588] According to section 17(1) of the Gas Act 1948, 'all property, rights, liabilities and obligations which, immediately before such date … were property, rights, liabilities and obligations of an undertaker to whom this Part of this Act applies.'[589] There were also a number of other statutory transfers through successive Gas Acts.[590] Gas production continued on the site until 1965 and the site was later sold to Kenton Homes Ltd and then purchased by Kenneth Jackson Ltd in 1966. Eleven properties were built upon the site. After one resident discovered a coal tar pit in their garden,[591] Doncaster MBC designated the area as a 'special site' in 2003.[592] The EA undertook remediation works and served a remediation notice[593] onto Transco in order to recover the costs it had incurred.[594] The EA initially identified a number of potential appropriate persons in its inspection: (i) The Gas Industry (various companies), (ii) Kenton Homes Ltd, (iii) Kenneth Jackson Ltd, (iv) the Ministry of Defence, (v) the Local Planning Authority and (vi) subsequent owners and occupiers.[595] However, Kenton Homes Ltd and Kenneth Jackson Ltd were liquidated[596] and there was no evidence that the MoD was an appropriate person.[597] If Transco was not a Class A appropriate person, then the eleven residents would have to incur the remediation

[587] ibid 1784A.
[588] *Transco* 2006 (n 585) para 21 (Forbes J). See also, section 17(1) of the Gas Act 1948.
[589] ibid, para 22.
[590] ibid, paras 23-24.
[591] ibid, para 33. This occurred in October 2001.
[592] ibid, para 34.
[593] EPA 1990, s 78N(3)(e).
[594] *Transco* 2006 (n 585) para 44 (Forbes J).
[595] ibid, para 39.
[596] ibid, para 40.
[597] ibid, para 41.

costs as 'one liability group' as the current owners and occupiers of the site.[598] The EA argued that Transco was the Class A appropriate person to bear the clean-up costs of the site. The Agency believed that Transco had inherited the liabilities of its predecessors through statutory transfer.[599] The potentially ambiguous language in this case was the term 'appropriate person', as found in section 78F of the EPA. Forbes J, sitting in the High Court, took a purposive interpretation, agreeing with the argument presented by the EA. The High Court ruled that the word 'appropriate person' in section 78F(2) of the EPA should be construed as to include statutory successors.[600] Through the use of *Pepper v Hart* (1993) AC 593, Forbes J was able to refer to *Hansard* in order to express the 'will and intention' of Parliament in relation to the word 'person' in section 78F of the EPA.[601] He stated that, 'the term "person" must be read and construed in its proper context in accordance with Parliament's intention, that this requires a construction that is not limited to normal concepts of strict legal personality.'[602] Following the High Court's judgment the case was 'leap-frogged' to the House of Lords,[603] where the High Court's decision was overruled.[604] The Law Lords believed that the High Court's construction of the word 'person' for the purposes of section 78F was 'nonsensical'.[605] It was found that the statutory language used in section 78F did not warrant recourse to *Hansard.*[606] Lord Scott of Foscote, who gave the leading judgment in the case, believed that the High Court's decision made 'a quite impossible construction to place on the uncomplicated and easily understandable statutory

[598] ibid, para 43.
[599] ibid, para 43.
[600] ibid, paras 73-88.
[601] ibid, para 48.
[602] ibid, para 56.
[603] Administration of Justice Act (AJA) 1969, ss 12-15.
[604] *Transco* 2007 (n 586) (Lord Scott of Foscote).
[605] ibid, para 20.
[606] ibid, para 23.

language.'[607] The House of Lords' judgment stated that the 'polluter should pay' for causing or knowingly permitting contamination, although their Lordships did not agree that successors-in-title fell within the meaning of a Class A appropriate person.[608] Thus, the appeal was allowed[609] and the Agency's decision was quashed.[610]

Hart suggests that the reason why Forbes J may have been so eager to extend the boundaries of liability in the *Transco* case is because, 'Issues of statutory succession would directly affect approximately 2000 gasworks, which are notorious for giving rise to serious contamination problems.'[611] The costs associated with cleaning-up former gas works are usually high. Also, many of the sites are abandoned and the clean-up costs are quite often paid by the public sector. In *Transco*, Forbes J tried to shift the blame onto the statutory successor of the B&DG, the SCY&DGC and the EMGC, the original polluters. This was intended to place the burden of remediation costs onto the private sector. Forbes J's decision shows a hint of the reasoning that was taken by the Eleventh Circuit Court in *Fleet Factors II*. If the House of Lords had not interpreted section 78F of EPA literally, overruling the High Court's initial purposive interpretation, then this could have meant that Class A liability would have extended to persons that were not the original polluters. Lord Neuberger stated in his judgment, 'However, there are also arguments against extending the concept of "the polluter" beyond the original polluter, for instance to entities which happen to have acquired the whole or part of the business of a polluter.'[612] Thornton also suggests that *Transco*, while not dealing with the issue directly, shows how the EA can include 'property

[607] ibid, para 19.
[608] ibid, para 24.
[609] ibid.
[610] ibid.
[611] D Hart, 'Case Commentaries Bawtry reversed: just what the statute says: no more and no less?' (2007) 4 *Env Liability* 188, 190.
[612] *Transco* 2007 (n 586) para 29 (Lord Neuberger of Abbotsbury).

developers within an initial group of potential class A appropriate persons' as persons that knowingly permitted the pollution.[613] Further to this Thornton suggests that a lender was originally included in the liability group as a knowingly permitter,[614] but 'the Agency excluded the company on the basis the lender liability exclusion applied.'[615]

4.1.4. The 6 Class A Exclusion Tests

There are six tests that exclude Class A liability under Part IIA of the EPA.[616] However, the exemptions should not be applied if all of the members of the liability group are excluded by applying the tests.[617] The following six tests are applied sequentially:

- Excluded Activities[618]
- Payments for Remediation[619]
- Sold with Information[620]

[613] Thornton, 'Contaminated land: the latest developments' (n 38) 11.
[614] ibid, 13.
[615] ibid.
[616] Defra 2012 (n 21) paras 7.38 – 7.61.
[617] ibid, para 7.32(c).
[618] ibid, para 7.38 – 7.39.
[619] ibid, para 7.40:"The purpose of this test is to exclude from liability those who have already, in effect, met the irresponsibilities by making certain kinds of payment to some other member of the liability group, which would have been sufficient to pay for adequate remediation".
[620] ibid, paras 7.46 – 7.50: As the name suggests, when someone who is a Class A appropriate person, because they have either caused or knowingly permitted the substances to be in, on or under the land, but has sold the land to a person, *bone fide*, with the information of the land's presence of contamination then the liability for the contamination is left to the purchaser.

- Changes to the Substances[621]

- Escaped Substances[622]

- Introduction of Pathways or Receptors[623]

For the purposes of this thesis, only three tests will be analysed in any amount of depth. These exclusions are most likely to apply to lenders that deal with suspect land during the course of their commercial loan financing. The three exclusion tests are:

4.1.4.1. 'Excluded Activities'

The guidance gives a number of circumstances in which a specific activity may be regarded as 'excluded' from the remit of Class A liability. The activities are, 'ones which, in the Government's view, carry such limited responsibility (if any) that exclusion would be justified.'[624] The excluded activities include things such as, 'the providing (or withholding) of financial assistance to another person (whether or not the other person is a member of the liability group).'[625] This test is vitally important to banks. This is because the exemption does not say that a bank could never cause or knowingly permit pollution, but, rather, that insofar as this may result from providing or withholding finance, they have the benefit of the first exemption. Therefore, there is no absolute guarantee that a bank is excluded from liability.

[621] ibid, paras 7.51 – 7.53.
[622] ibid, paras 7.45 – 7.56.
[623] ibid, paras 7.57 – 7.61.
[624] ibid, para 7.38.
[625] ibid, para 7.39(a).

4.1.4.2. 'Sold with information'

Where, prior to the sale becoming legally binding, land is sold to a buyer at arms' length, and the buyer is provided with information that makes them reasonably aware about the presence of contamination in, on or under the land, without any misrepresentation or fraud, then Class A liability will be excluded to the seller of that land.[626] This exclusion only applies where the seller no longer retains interest or rights over the estate after the sale of the freehold estate or long lease.[627]

4.1.4.3. 'Introduction of pathways or receptors'

Paragraph 7.58 of the statutory guidance suggests that a person will be excluded where, 'The effect of later actions has been to introduce the pathway or receptor which form part of the significant contaminant linkage in question.'[628] Thus, if the relevant action or omission of others causes the introduction of new pathways or receptors to land, and that action or omission causes a significant contaminant linkage to materialise, Test 6 may be used as exclusion to Class A liability.[629] The application of this test was evaluated in the *Circular Facilities* case, as above.[630]

4.2. Class B Liability

It is the case with many environmental laws that if the person that caused or knowingly permitted pollution cannot be found,[631] liability will then be transferred to the current

[626] ibid, para 7.47.
[627] Bell, McGillivray and Pedersen (n 28) 612.
[628] Defra 2012 (n 21) para 7.58(d).
[629] ibid, para 7.57.
[630] *Circular Facilities* (n 530).
[631] e.g. EPA 1990, ss 59 and 78F(4). See also, O'Donovan (n 63) 604.

owner or occupier of the land[632] (i.e. Class B liability).[633] Having a 'registered charge' (e.g. a mortgage) over property is unlikely to lead to Class B liability, since it 'does not confer ownership on the mortgagee.'[634] *Westminster City Council v Haymarket Publishing* [1981] 1 WLR 677 concerned whether a mortgagee that is not 'in possession' could be made liable under section 17A of the General Rate Act 1967 as the 'person entitled to possession'. Lord Denning believed that unless a borrower took possession through the receipt of rents or by foreclosure, it could not be liable as the person that is entitled to possession.[635] However, banks are capable of incurring liability for environmental damage as a 'mortgagee in possession' of environmentally suspect property.[636] Upon a mortgagor's default or when the mortgage money becomes due, there are two ways in which a mortgagee may 'take possession' of property;[637] by the receipt of rents[638] (i.e. the mortgagor's equity of redemption)[639] or by physically foreclosing the property.[640] In relation to the receipt of rents Bowen LJ in *Noyes v Pollock* (1886) 32 Ch D 53 emphasised that merely taking rents is not enough to incur liability: 'He may take rents; that is not enough unless he takes the rent in such a way to take upon himself, and out of the hands of the mortgagor, the business and duty of collecting and being diligent.'[641] The power to possess property can be conferred by law or through an expressed provision in the mortgage deed.[642] Section 101 of the Law of Property Act 1925 outlines the 'powers incidental to estate or interest of

[632] ibid.
[633] Defra 2012 (n 21) para 7.3(a).
[634] *Southern Water Authority v Nature Conservancy Council* [1992] 1 WLR 775. See also, O'Donovan (n 63) 605.
[635] *Westminster City Council v Haymarket Publishing* [1981] 1 WLR 677, 680 (Lord Denning).
[636] Hooley (n 52) 413.
[637] O'Donovan (n 63) 605.
[638] See, *Noyes v Pollock* (1886) 32 Ch D 53 (Bowen LJ). See also, Jarvis and Fordham (n 51) 131.
[639] O'Donovan (n 63) 605.
[640] ibid, 553.
[641] *Noyes* (n 638) 64.
[642] ibid.

mortgagee'.[643] Section 101(1)(i) confers a power upon mortgagees (as if it were written into the mortgage deed) allowing it to take possession and sell property when the mortgage money is due.[644] A mortgagee or an agent of the mortgagee may also enter the property physically[645] under specific provision of the mortgage deed.[646] When borrowers default on their mortgage repayments, it is standard practice for a secured creditor to physically foreclose upon the estate in order to secure their investments.[647] Taking physical possession of property is the most likely way that a mortgagee will incur liability for remediation costs as a Class B appropriate person under Part IIA.[648] O'Donovan states that, 'Foreclosure involves the extinguishment of the mortgagor's equity of redemption, leaving the mortgagee as the absolute owner of the property.'[649] The common law has developed its own stance on what is meant by the phrase, 'being in possession [or control]' of property.[650] Generally, a mortgagee in possession of the property is deemed to have sufficient 'control' to incur liability as an owner or occupier.[651] This can be seen in a pre-Part IIA case. Following the foreclosure of a borrower's contaminated property, Midland Bank was served with a remediation notice by the local authority, as it was identified as the occupier of the land. It was required to clean-up of over 13,000 contaminated tyres that were deposited on the land during its borrower's ownership.[652] It is important to make it clear that, in this case, Midland Bank

[643] Law of Property Act 1925, s 101.
[644] ibid, s 101(1)(i).
[645] O'Donovan (n 63) 553.
[646] ibid.
[647] ibid.
[648] Egede and Lee (n 56) 876.
[649] O'Donovan (n 63) 605.
[650] Hooley (n 52) 413.
[651] See, *Westminster City Council* (n 635) 680 (Lord Denning); and *Maguire v Leigh-on-Sea UDC* (1906) 95 LT 319. However cf *Solomons v Gertzenstein* [1954] 2 QB 243; and *Midland Bank v Conway* 1 WLR 1165.
[652] *Devonshire WRA v Roberts Warren & Snow* (1995) 7 ELM 105. See also, R Lee, 'Contaminated Land and Secured Lending: Midland Bank Clean Up' (1995) 14(1) International Banking and Financial Law 1.

was held liable under Part II of the EPA, which concerns offences relating to waste; this was not, therefore, a Part IIA case. In order to assess Class B liability further, the individual terms of 'owner' and 'occupier' are discussed below.

4.2.1. Liability as an 'Owner'

The definition of the term 'owner', according to section 78A(9) of the EPA, is:

> 'a person (other than a mortgagee not in possession) who, whether in his own right or as trustee for any other person, is entitled to receive the rack rent of the land, or where the land is not let at a rack rent, would be so entitled if it were so let.'[653]

After reviewing the American understanding of environmental lender liability, it is apparent that section 78A(9) of the EPA resembles the 'secured-creditor' exemption in 42 U.S.C. section 9601(20)(a). This definition excludes 'a person other than a mortgagee not in possession' from being determined as a Class B appropriate person. This phrase was created to protect mortgagees. It means that if the bank does not take possession of its secured interests, it cannot be found liable for the remediation costs of contamination in, on or under land. While this definition of owner offers some protection to lenders, it does not represent a legally binding exemption for secured creditors as at 42 U.S.C. section 9601(20)(E) of CERCLA. The extent to which liability can attach to lenders by virtue of being a mortgagee in possession of land is so far undefined under Part IIA. For example, are there some activities that do not fall within

[653] EPA 1990, s 78(9).

the definition's exception? Hood suggests that, 'Under English law, a difference between a charge and a mortgage is that the former does not require possession.'[654] He goes on to state that:

> 'Whilst a floating charge under English law has been described as 'a floating mortgage', it is suggested that the exception created in the definition of 'owner' for a person other than a mortgagee not in possession, is not, on the face of it, wide enough to include a floating charge.' [655]

Hood demonstrates that lenders are not totally free from Class B liability under Part IIA. There are some forms of ownership that do not fall within the meaning of a 'mortgagee not in possession'. Nevertheless, Part IIA liability can be prevented when recovering secured assets e.g. through the appointment of insolvency practitioners.[656] The next section looks at liability as an 'occupier' of land.

4.2.2. Liability as an 'Occupier'

The term 'occupier' is undefined within any section of the EPA 1990.[657] However, there are a number of statutory and common law sources (e.g. the Occupiers' Liability Act 1957 and the tort of nuisance), which have attempted to shed light on the term's meaning.[658] To be classed as an occupier of land some sort of 'possession or control' is needed (see below). It is necessary, therefore, to look at a person's degree of lawful

[654] Hood (n 71) para 13.64.
[655] ibid, para 13.65.
[656] infra, ch 4.
[657] Hooley (n 52) 413.
[658] Jarvis and Fordham (n 51) 129.

assertion over the premises.[659] Jarvis and Fordham categorise three different judicial approaches that have been used to analyse liability as an 'occupier'.[660] The different approaches derive largely from two cases.[661] They describe the first category as 'the anti-analogy principle' (i.e. that the definition does not depend upon the perfect analogy of what an occupier must be, but instead must be decided on the facts of the particular case in question).[662] This principle is based upon the approach that was taken by Lord Mustill in *Southern Water Authority v Nature Conservancy Council* [1992] 1 WLR 775[663] and by Lord Denning in the case of *Wheat v E Lacon & Co. Ltd* [1966] 1 All ER 582.[664] The second approach to what constitutes an 'occupier' is described as 'the control approach'.[665] This relies on the control and/or possession that a legal person has over the property.[666] A classic example of the 'control' approach can be found in *Wheat v Lacon*,[667] where the House of Lords had to decide whether two defendants could be described as 'occupiers' under the Occupiers' Liability Act 1957. It was held that in order to be classed as an occupier under the Act of 1957, the defendant must have 'a sufficient degree of control over the premises'.[668] The case of *Harris v Birkenhead* [1976] 1 WLR 279 went further than *Wheat v Lacon* by suggesting that 'possession' can be found by showing that a person has a legal title to the property.[669] Jarvis and Fordham label the final approach taken by the judiciary as 'the comprehensive and

[659] Marks (n 49) 16.
[660] Jarvis and Fordham (n 51) 145-155.
[661] ibid. Jarvis and Fordham use *Wheat v E Lacon & Co Ltd* [1966] 1 All ER 552 and *Southern Water Authority* (n 634) to describe the three approaches that the courts may use to identify occupation of property.
[662] ibid, 146-147.
[663] *Southern Water Authority* (n 634) 781 (Lord Mustill).
[664] *Wheat* (n 661) 577 (Lord Denning).
[665] Jarvis and Fordham (n 51) 148-149.
[666] ibid 149. Jarvis and Fordham outline the cases relating to the control approach, as: *Wheat* (n 661); *R v Mogford* [1970] 1 WLR 988; and *R v Tao* [1977] QB 141.
[667] *Wheat* (n 661).
[668] ibid, 578 (Lord Denning). See also, Jarvis and Fordham (n 51) 148.
[669] *Harris v Birkenhead* [1976] 1 WLR 279.

stable relationship approach'.[670] This approach was again developed from Lord Mustill's judgment in *Southern Water Authority v Nature Conservancy Council* [1992] 1 WLR 775.[671] In *Southern Water*, his Lordship decided that the factor that determines whether a person is an occupier is whether they can be regarded as being in a 'comprehensive and stable relationship' with the property.[672] Now that the Part IIA regime's liability has been considered, the chapter will go on to outline the system of remediation under the contaminated land regime.

5. Remediation[673]

Section 78A(7) of the EPA 1990 defines 'remediation' as:

> '(a) the doing of anything for the purpose of assessing the condition of – (i) the contaminated land in question; or (ii) any controlled waters affected by that land; or (iii) any land adjoining or adjacent to that land; (b) the doing of any works, the carrying out of any operations or the taking of any steps in relation to any such land for the purpose – (i) of preventing or minimising, or remedying or mitigating the effects of, any significant harm (or significant pollution of controlled waters), by reason of which the contaminated land is such land; or (ii) of restoring the land or waters to their former state; or (c) the making of subsequent inspections from time to time

[670] *Southern Water Authority* (n 634) 775.
[671] ibid.
[672] Jarvis and Fordham (n 51) 149.
[673] For a good outline of the remediation process under Part IIA see Lee, 'Contaminated Land Regime: The Remediation Process' (n 29).

for the purpose of keeping under review the condition of the land or waters.'

[674]

After determination, the guidance recommends that the local authority should consider the necessary remediation that needs to be carried out on the land in order to remove the risks posed by contaminant linkages.[675] A number of remediation techniques can be used on their own or sequentially,[676] as long as it constitutes the Best Practicable Technique ('BPT') for cleaning-up the site.[677] The statutory guidance says that:

'The broad aim of remediation should be:

a) to remove identified significant contaminant linkages; and

b) to take reasonable measures to remedy the harm or pollution that has been caused.'[678]

Before serving a remediation notice section 78H(5)(a) – (d) of Part IIA should be considered by the enforcing authority.[679] This section outlines circumstances where it is not necessary for the enforcing authority to serve a remediation notice: for example, 'if the authority is satisfied that appropriate things are being, or will be, done by way of remediation without the service of a remediation notice on that person.'[680] The authority is also not obliged to serve a remediation notice where section 78N of the

[674] EPA 1990, s 78A(7). See also, Defra 2012 (n 21) para. 6.1.
[675] Defra 2012 (n 21) para 6.3.
[676] ibid, paras 6.6 -6.7.
[677] ibid, para 6.22.
[678] ibid, para 6.5.
[679] EPA 1990, s 78H(5)(a)-(d).
[680] ibid, s 78H(5)(b).

EPA applies.[681] Section 78N outlines the powers of the local authorities to carry out remediation.[682] The authority can undertake remediation works and then recover the reasonable costs incurred from appropriate persons.[683] This provision reflects the statutory powers of the US EPA under CERCLA. In order to recover costs, the authority must issue a 'charging notice' specifying the fee owed and the rate of interest.[684] The charge may be paid either by instalments or in one lump sum.[685] Like the remediation notice, a charging notice may be appealed within a period of twenty-one days of it being served.[686] The county court that carries out the appeal may confirm the notice's validity without modification, affirm the decision but with a modification or reject the decision completely.[687] Local authorities must have regard to the 'financial circumstances of those concerned'[688] including under section 78P(2) of the EPA 'to any hardship which the recovery may cause to the person from whom the cost is recoverable.'[689] Before serving a remediation notice, 'the enforcing authority shall reasonably endeavour to consult – (a) the person on whom the notice is to be served; (b) the owner of any land which the notice relates; (c) any person who appears to that authority to be in occupation of the whole or any part of the land; and (d) any person of such other description as may be prescribed.'[690] The remediation notice highlights the required remedial action or remediation scheme for clean-up.[691] It must also apportion the liability and apply the relevant exclusion tests that are available to limit liability.[692] When a remediation notice

[681] ibid, s 78H(5)(d).
[682] ibid, s 78N(1).
[683] ibid, s 78P(1).
[684] EPA 1990, s. 78P(5).
[685] ibid, s 78P(12).
[686] ibid, s 78P(8).
[687] ibid, s 78P(9), (a)-(c).
[688] EPA 1990, s 78P(2)(a); Defra 2012 (n 21), para 7.26.
[689] ibid.
[690] EPA 1990, s 78H(1)(a)-(d).
[691] Defra 2012 (n 21), para 6.3.
[692] EPA 1990, s 78E(1).

is served, the person that receives the notice reserves their statutory right to appeal the decision.[693] Section 78L(1) of the EPA states that the appellate authority may either quash[694] or affirm the remediation notice.[695] Failure to comply with a remediation notice is a criminal offence.[696] Prosecution upon summary conviction may lead to a fine not exceeding Level 5 on the standard scale.[697] However, if the authority feels that a Level 5 fine would be an 'ineffectual remedy', the case may be taken to the High Court 'for the purposes of securing compliance with the remediation notice.'[698] The local authority may also ask for a 'remediation statement'.[699] According to section 78H(7) of the EPA, the 'remediation statement' is used to record the progress of the remediation works.[700] Section 78H(9) of the EPA states that if a remediation statement is ignored or completed insufficiently, the enforcing authority dealing with the site may recover costs from the person.[701]

6. The Contaminated Land Regime and the System of Land Use Planning

Planning permission is needed before any type 'development'[702] can take place.[703] Permission may be granted by, amongst other things, a development order[704] or by a local planning authority (LPA)[705] upon a successful application to the Secretary of State

[693] ibid, s 78L.
[694] ibid, s 78L(1)(a).
[695] ibid, s 78L(1)(b).
[696] ibid, s 78M(1).
[697] ibid, s 78M(3).
[698] ibid, s 78M(6).
[699] ibid, s 78H(7).
[700] ibid, s 78H(7). See also, Lee, 'Contaminated land - remediation and liabilities' (n 29) 172.
[701] EPA 1990, s 78H(8).
[702] Town and Country Planning Act 1990, s 55. See also, Planning Act 2008, s 32.
[703] ibid, s 57.
[704] ibid, s 58(a).
[705] ibid, s 58(b).

for the Environment or LPA for the grant of planning permission.[706] Any 'environmental effects' that may stem from a development must be considered where the Secretary of State makes provision for such effects to be considered.[707] Planning decisions are said to be 'linked' with environmental protection.[708] Thornton, for instance, suggests that, 'Environmental impact assessments (EIA)[709] tend to be viewed as the cross-over point between environmental and planning law and are an important feature of planning control.'[710] When dealing with a planning application LPAs must have regard to any 'material considerations' in the development plan.[711] In *Gateshead MBC v Secretary of State for the Environment* [1995] Env LR 37[712] planning permission for a clinical waste incinerator was refused by the planning authority because of its potential to create environmental impacts. On appeal to the Secretary of State for the Environment, planning permission was granted on the basis that the Pollution Inspectorate would monitor the incinerator's emissions. The legal issue for the court to determine was whether the Secretary of State was justified in delegating planning responsibilities to the Pollution Inspectorate. Glidewell LJ ruled that the Secretary of State was justified in assigning responsibility as it was within the Inspectorate's powers to deal with the task given to it.[713] Similarly, in *Newport County Borough Council v Secretary of State for Wales & Browning Ferris Environmental*

[706] ibid, s 62.
[707] ibid, s 71A; NPPF (n 4) paras 109 – 125.
[708] J Thornton, '"Mind the gap": a note on the boundaries between environmental and planning law' (2008) 5 JPL 609.
[709] Council Directive 85/337/EEC on the assessment of the effects of certain public and private projects on the environment (EIA Directive) [1985] OJ L 175, 40-48 as amended by 97/11/EC and 2003/35/EC. See also, Town and Country Planning (Environmental Impact Assessment) (England and Wales) Regulations, SI 1999/293.
[710] Thornton, '"Mind the gap"' (n 708) 612.
[711] TCPA 1990, s 70(2); s 38(6) of the Planning and Compulsory Purchase Act (PCPA) 2004. See also, NPPF (n 4) 27.
[712] *Gateshead MBC v Secretary of State for the Environment* [1995] Env LR 37. See also *R v Bolton MBC ex p Kirkman* [1998] Env LR 719. See also, Thornton '"Mind the gap"' (n 708) 10.
[713] ibid, 50 (Glidewell LJ). See also, *Newport County Borough Council v Secretary of State for Wales & Browning Ferris Environmental Services Limited* [1998] JPL 377.

Services Limited [1998] JPL 377[714] Hutchison and Aldous LJs held that refusal for planning permission must be objectively justified and therefore decided against an inspector's decision to refuse planning permission for a chemical treatment works because of a 'genuine public perception of danger'.[715] However, in *Hopkins Developments Ltd v First Secretary of State* [2006] EWHC 2823 the court ruled in favour of an inspector's decision to refuse planning permission for a concrete plant on the grounds that the dust generated from the plant would be an inappropriate use of the land.[716] Thornton suggests that the reason why this decision may have been different from *Gateshead MBC* is, 'explained by the fact that the concern in question related to dust, which is a less specialised environmental issue than air quality.'[717]

The planning system has been so successful in enforcing contaminated land clean-up that it is sometimes difficult to distinguish whether Part IIA or the planning system is the primary mechanism for driving contaminated land remediation.[718] Nevertheless, it is important to note that what has been achieved through planning and voluntary remediation has been assisted by the fallback powers of local authorities to use Part IIA. The planning policy guidance has recently been subject to revision. Planning Policy Statement 23 (PPS 23)[719] (now revoked) used to complement the Part IIA regime by seeking to achieve the contaminated land regime's objectives through land use planning. PPS 23 allowed the discovery of contamination on a development site in England to be categorised as a 'material planning consideration', and thereby subject

[714] *Newport* (n 713).
[715] ibid, 181 (Hutchinson LJ) and 184 (Aldous LJ). cf the dissenting judgment of Staughton LJ.
[716] *Hopkins Developments Ltd v First Secretary of State* [2007] Env LR 14, 15 (Mr George Bartlett QC).
[717] Thornton, '"Mind the gap"' (n 708) 611.
[718] See M Purdue, 'The Relationship between Development Control and Specialist Pollution Controls: Which is the tail and which the dog?' [1999] JPL 585.
[719] Office of the Deputy Prime Minister, 'Planning Policy Statement 23: Planning and Pollution Control' (ODPM 2004).

to remediation through the planning system.[720] Lenders should be aware that PPS 23 has now been consolidated into the newly created National Planning Policy Framework (NPPF), as is the case with the other Policy Statements (PSs) on planning. The draft NPPF was a topic of much contention. Ecological and political activists saw it as a possible threat to the protection of England's rural countryside. When introduced two years ago, the NPPF replaced the one-thousand four-hundred pages of planning guidance with one consolidated document of fifty-eight pages. In accordance with the NPPF, local people and their accountable councils can 'produce their own distinctive local and neighbourhood plans, which reflect the needs and priorities of their local communities.'[721] In relation to contaminated land, paragraph 121 of the NPPF states:

> 'after remediation as a minimum, land should not be capable of being determined as contaminated land under Part IIA of the Environmental Protection Act 1990;'[722]

Considering the fact that the Government's core policies and principles concerning land pollution and planning were once outlined in an entire planning policy guidance (PPS 23), paragraph 121 provides little assurance that the new Framework will be more effective at identifying and remediating land that is affected by contamination. Through the NPPF the Government's needs are served. It is clearly evident that sustainability has been replaced by economic considerations. For example, the 'presumption in favour of sustainable development' at paragraph 14 of the NPPF is contentious and may be accused of putting England's green spaces at risk of development. Since 2012 there

[720] ibid. See also, *Gateshead* (n 712).
[721] NPPF (n 4), para 1.
[722] ibid, para 121.

have been a number of cases regarding the application of paragraph 14. In *William Davis Ltd v SSCLG* [2013] EWHC 3058 (Admin) Lang J held that paragraph 14 of the NPPF only applies to sustainable development,[723] since, 'It would be contrary to the fundamental principles of NPFF if the presumption in favour of development in paragraph 14 applied equally to sustainable and non-sustainable development.'[724] However, Lang J's decision was recently rejected by the Secretary of State for Communities and Local Government,[725] who stated that 'the weight of High Court authority runs contrary to Lang J's view.'[726] By refusing to follow *William Davis Ltd's* interpretation of paragraph 14 'more than 1,000 homes'[727] will now be built in Droitwich. What is more distressing is that since the NPPF was introduced, 'Only a minority of (27%) local authorities outside London are setting local targets for the re-use of brownfield land in their area.'[728] There is also uncertainty as to the impact that the Localism Act 2011[729] will have upon the new planning framework. The Localism Act 2011 removes regional strategies,[730] allowing new rights and powers to be localised.[731] For example, there is now a community right to challenge planning

[723] *William Davis Ltd v SSCLG* [2013] EWHC 3058 (Admin) para 37 (Lang J).
[724] ibid.
[725] H Stephens, *Report to the Secretary of State for Communities and Local Government* (The Planning Inspectorate, 6 June 2014) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/328158/Recovered_appeal__Pulley_Lane__Newland_Road__Newland_Lane__Primsland_Way__Droitwich_Spa__Wychavon_DC___refs2199085_and_2199426__2_July_2014_.pdf> accessed 11 September 2014.
[726] ibid, para 3.31. See, *Stratford on Avon District Council v Secretary of State for Communities and Local Government* [2013] EWHC 2074 (Admin); *Tewkesbury Borough Council v Secretary of State for Communities and Local Government and others* [2013] EWHC 286 (Admin); and *Anita Colman v Secretary of State for Communities and Local Government and others* [2013] EWHC 1138 (Admin).
[727] C Bywater, 'Droitwich appeals: uncertainty over the presumption in favour of sustainable development' (*Lexology*, 24 July 2014) <https://www.lexology.com/library/detail.aspx?g=6e5e8b37-a88b-4914-98b5-158b87d061b9> accessed 11 September 2014.
[728] Campaign to Protect Rural England, 'Community Control or Countryside Chaos? The effect of the National Planning Policy Framework two years on' (CPRE, March 2014) 18 <file:///C:/Users/Lloyd/Downloads/NPPF_two_years_on.pdf> accessed11 September 2014.
[729] Localism Act 2011.
[730] ibid, s 109.
[731] ibid, pt 5. See also, Department for Communities and Local Government, *A plain English guide to the Localism Act* (DCLG, November 2011) 8.

decisions.[732] Despite having more powers, there is uncertainty as to how LPAs should exercise their new responsibilities.[733] As discussed in Chapter 1, removing regional government may be harmful for sustainable development in England's regions.[734] As with Part IIA, the recent changes to the system of land use planning show how the Coalition Government has created policy to encourage short-term economic gains, allowing the wrong type of property development to take place.

7. The Success of the Contaminated Land Regime

This section evaluates the success of the contaminated land regime so far. It provides an essential link to later chapters, explaining why lenders consider direct lender liability to be low risk to their commercial loan financing. Measuring the success of the regime is difficult because the exact amount of contaminated land in need of remediation is currently unknown. Nevertheless, the EA is placed under a statutory requirement to 'prepare and publish reports on the state of contaminated land.'[735] The contaminated land regime's progress was first outlined in 2002 by the EA.[736] However, a more up-to-date account of Part IIA's success was released by the EA in 2009. *Reporting the Evidence* (2009)[737] evaluates the progress of Part IIA from its implementation on 1 April 2000 up to 31 March 2007.[738] By 2007, 781 contaminated sites (which included 35 'special sites') had been determined and inspected by local authorities throughout England and Wales.[739] Of the 781 sites determined, the 2009 report states that only 144

[732] ibid.
[733] See, *Tewkesbury* (n 726), paras 49-52 (Males J); and *R (Daws Hill Neighbourhood Forum) v Wycombe District Council and others* [2013] EWHC 513 (Admin).
[734] infra, ch 1, pg 31.
[735] EPA 1990, s 78U.
[736] Environment Agency, *Dealing with contaminated land in England* (n 348).
[737] Environment Agency, *Reporting the Evidence* (n 16).
[738] ibid 1.
[739] ibid 8.

have been fully remediated.[740] The fact that only 144 sites have been remediated out of a total of 781 is unsurprising since the remediation of contaminated land can be expensive. In March 2007, total remediation was priced at £20.5 million, amounting to an average payment of around £250,000 per hectare of remediation undertaken.[741] The 2009 Report shows that land contamination is being dealt with primarily through the system of land use planning and voluntary remediation.[742] Nevertheless, according to the Report, only around ten per cent of all contaminated land determinations were remediated under the Part IIA regime.[743] Also up until March 2007 local authorities had only averaged a ten per cent inspection rate for their areas;[744] this figure is much lower than expected.[745] In their interview, Respondent 3 suggested that the reason why Part IIA has made so few determinations is because of the ineffective resource allocation amongst the regime's regulators. Their excerpt from the interview follows:

> *R_3: Absolutely… you know… and I think… to be honest… part of the problem is the regulators, like the EA are often in quite a weak position. It is actually a big deal for them to get approval internally to enforce some of these laws because it costs the Agency money and the outcome is not certain. They could lose the case, or, for whatever reason, they could put money into trying to prosecute it and they may come off worse. There's [sic] so many other things they could be prosecuting, which are like "slam dunk" cases… you know… they know they'll get convictions… they could go after*

[740] ibid 14.
[741] Department of Environment, Food and Rural Affairs and Welsh Assembly, *Summary of the responses to the consultation on changes to the Contaminated Land Regime under Part 2A of the Environmental Protection Act 1990: 21 December 2010 - 15 March 2011* (Defra and WA, 2010).
[742] Environment Agency, *Reporting the Evidence* (n 16) 3.
[743] ibid 5.
[744] ibid.
[745] ibid.

> *the easy ones, or they could go after one where there's no precedent and they might get their fingers burnt. And the EA these days, with all the cut backs, is under a lot of budgetary pressure. So I'm sure that, internally, it's quite difficult for EA inspectors to get approval to proceed with the legal cases; and I think that is a lot of the reason why some of these theoretical exposures never materialise because it's the Regulator that has to drive it; and it will either be… you know… the EA for special sites, or it'll be the local authorities. And the local authorities are even in a worse position because they don't have: (a) the technical competence internally to actually form a judgment on whether or not they have a good case; (b) they don't have money to put it into consultancy to get the data they need to actually decide if there is a significant threat of significant harm; and (c) they have even less money to actually launch a legal challenge against some quite big organisations, potentially. So the law's there and probably the environmental contamination situations are there, but there's no push from the regulators to actually force through these. I think that in the US it is completely different… you know… because people will force through an opportunity to make money and they will use whatever means they can to get lawyers in.* [746]

This interview extract confirms the regulators' 'weak position' to enforce the contaminated land regime. It ties in with the economic overview given in Chapter 1.[747] That chapter showed that, in a period of austerity, the identification and remediation of contaminated land has been severely affected by the Coalition Government's reduce

[746] Interview with Respondent 3.
[747] Refer to ch 1, pp 25-38.

red tape initiative, and cuts in public sector funding. Local authorities and the Environment Agency are often unable to carry out their objectives under the regulatory regime because they lack the necessary financial support that is required to inspect a site for the presence of contamination in, on or under the land. Phase II risk assessment[748] takes time, and, depending upon the site, can come at a considerable cost. Phase II work is inevitably going to be impacted by the recent changes that have been made to contaminated land policy. Ultimately, the regulators' position has been significantly affected by the current Government's initiatives for securing short-term economic growth in an age of austerity.

III. Conclusion

In conclusion, this chapter has outlined, in detail, the regulatory regime for identifying and remediating historic contaminated land in the UK. The chapter began with an analysis of CERCLA, which was brought into force to deal with the US's abandoned hazardous waste sites. Both the pre- and post-1996 interpretations of the 'secured creditor exemption' were discussed. It is clear that the American banks' experience of lender liability under CERCLA is not be the same as Part IIA and UK lenders. Nevertheless, it was necessary to write about CERCLA in this chapter. The US experience of lender liability in the 1980s was mentioned, on several occasions, in the interview data, and in the interests of clarity, a brief overview of CERCLA was required. Following an evaluation of CERCLA, the chapter then went on to assess the situation in the UK. In order to analyse the current direct lender liability threat to UK banks, it was essential to outline the contaminated land regime under Part IIA of the

[748] infra, ch 6, pg 266.

EPA. Such a detailed consideration of Part IIA is important, as this chapter provides an important grounding for later discussion of the interview data. The next chapter (Chapter 3) looks at a number of other laws that are designed to regulate land and water pollution.

Chapter 3:

Lender Liability, Current Pollution and Emerging Risks

There are a number of 'overlapping controls'[749] for the prevention and remediation of land pollution. For example, Tromans states that:

> ' … there is plenty in existing and proposed environmental law, both in case law and statute, to give the banking and lending industry cause to sit back, think hard, and perhaps revise some of its traditional attitudes as to the relevance of environmental matters.' [750]

This chapter (Chapter 3) reviews the miscellaneous bodies of law that pose a risk to lenders. As with Chapter 2, this chapter relates to the part of the overarching research question which concerns how the banks' perceptions of the threat of lender liability, as well as the other environmental risks, have changed over the last twenty-five years. It does this by outlining the statutory and common laws governing current land pollution issues, and demonstrating the low lender liability risk that presently exists. The chapter is also, therefore, highly relevant for answering sub-question 1, point 1, as that question evaluates the extent to which environmental legislation poses a 'real risk' for banks. The 'common law sources' that are evaluated, include:

- Nuisance

[749] Bell, McGillivray and Pedersen (n 28) 586.
[750] Tromans (n 71) 433.

- The rule in *Rylands v Fletcher*[751]

- Negligence

Following an analysis of the 'toxic torts', the chapter then outlines national, statutory sources of law that regulate activities on land, and may create environment-related risks for lenders. The statutory laws analysed include:

- Environmental Damage (Prevention and Remediation) Regulations 2009[752]

- Environmental Permitting (England and Wales) Regulations 2010[753]

- Part II of the EPA 1990[754]

- Part III of the EPA 1990[755]

- Water Resources Act 1991[756]

- Wildlife and Countryside Act 1981[757]

To conclude, this chapter presents the 'emerging environmental risks' for banks according to the unique insights of the banking respondents. Thus, sub-question 1, point

[751] *John Rylands and Jehu Horrocks v Thomas Fletcher* (1868) LR 3 HL 330.
[752] Environmental Damage (Prevention and Remediation) Regulations 2009, SI 2009/153.
[753] Environmental Permitting (England & Wales) Regulations (EPR) 2010, SI 2010/675.
[754] Environmental Protection Act 1990, pt II.
[755] ibid, pt III.
[756] Water Resources Act 1991.
[757] Wildlife and Countryside Act 1981.

3 also links into this chapter; the legal analysis shows that the emphasis of environmental risk management in banks is changing – issues surrounding land pollution are gradually being replaced by other, more pressing concerns.

I. The Common Law

The common law may be used as a way to remedy a site subject to contamination. This section of the chapter provides an overview of nuisance and negligence (the 'toxic torts'), looking at how the torts apply in the environmental context.

A. Nuisance

In the nineteenth century, nuisance was used to respond to the increasing pollution that was generated as a by-product of the burgeoning industrial activity undertaken during that period.[758] As a result, it has now become an established environmental remedy.[759] Ultimately, the tort of nuisance is a balancing act that attempts to assess the property rights that exist between two parties by applying the legal maxim of *sic utere tuo ut alienum non laedas.*[760] The classic vignette used to illustrate this type of tortious action in an environmental legal claim is where a factory has emitted a noxious vapour into the ambient air, and that act then affects a neighbouring residential area.[761] Thus, a nuisance related action demands the court to weigh up Party A's ability to reasonably

[758] See, JF Brenner, 'Nuisance Law and the Industrial Revolution' (1974) 3 J Leg Stud 403-408; and JPS McLaren, 'Nuisance law and the industrial revolution – some lessons from social history' (1983) 3(2) OJLS 155.
[759] WVH Rogers (ed), *Winfield & Jolowicz on Tort* (18th edn, Sweet and Maxwell 2010).
[760] Martin (n 514) 432. *Sic utere tuo ut alienum non laedas* is translated into, 'So use your own property as not to injure your neighbour's.'
[761] See, *The Directors, etc. of the St Helen's Smelting Company v William Tipping* [1865] 11 ER 1483.

utilise his or her land, with Party B's right to protect and enjoy the land to which they hold title.[762] The law of nuisance is currently in a state of uncertainty. The traditional land lawyer might argue that the common law of nuisance has lost the conventional, medieval values that it once possessed.[763] However, the boundaries of nuisance have become blurred by the encroachment of negligence and the rule in *Rylands v Fletcher*. Brenner states that nuisance has been skewed by judicial activity in the nineteenth century, where industrial expansion and economic influences reduced the use of 'environmental torts' by the judiciary.[764]

Newark considers that nuisance is a purely proprietary based tort. He believes that the 'boundaries' of nuisance should be limited only to persons with a legal interest to the property being affected by the nuisance. On the other hand Lee suggests that private nuisance can be categorised into three groups: (1) a fault-based tort (overlaps with negligence in cases involving third party damage and Acts of God); (2) strict liability;[765] and (3) amenity harm. [766] She believes that the 'classic' nuisance case is one that deals with 'amenity' problems, i.e. 'an interference with the use and enjoyment of the land.' Despite the recent dissention that has occurred within this area, things have swung back in Newark's direction.

[762] Ronald Coase, the environmental economist, used toxic tort cases to advance his thesis on social cost. Read, R Coase, 'The Problem of Social Cost' (1960) *3* Journal of Law and Economics 1. For an alternative theory to Coase theorem, see, AC Pigou, *The Economics of Welfare* (4th edn, London, Macmillian and Co 1920). See also, D Campbell, 'Of Coase and Corn: A (Sort of) Defence of Private Nuisance' (2000) 63(2) MLR 197-215.
[763] FH Newark, 'The Boundaries of Nuisance' (1949) 65 LQR 480.
[764] Brenner (n 758) 403.
[765] *Cambridge Water v Eastern Counties Leather* [1994] 1 All ER.
[766] M Lee, 'What is private nuisance?' (2003) LQR 298.

Common law nuisance is also being undermined by the codification of this field of law into the EPA 1990.[767] There are currently four different types of nuisance that may pose a risk to land: (1) private nuisance; (2) public nuisance; (3) statutory nuisance; and (4) the rule in *Rylands v Fletcher*.[768] As this section of the thesis outlines common law nuisance, statutory nuisance is evaluated with the statutory sources.

1. Private Nuisance

A private nuisance can be described as, 'an unlawful interference with a person's use or enjoyment of land, or some right over, or in connection with it.'[769] Case law suggests that a private nuisance can exist in three forms: (1) encroachment on a neighbour's land; (2) direct physical injury to the land; and (3) interference with the enjoyment of the land (also known as 'amenity' or 'sensibility' cases).[770] Judicial interpretation has suggested that the types of interferences that fit within these categories are 'protean' in nature. In *Sedleigh-Denfield v O' Callaghan et al.* [1940] AC 880, Lord Wright states that, 'It is impossible to give any precise or universal formula, but it may be broadly said that a useful test is perhaps what is reasonable according to the ordinary usages of mankind living in society… The forms which nuisance may take are protean.' [771]

Environmentally damaging activities in a claim for private nuisance can include such things as: noxious smells and gaseous vapours,[772] encroaching vegetation,[773]

[767] EPA 1990, pt III.
[768] *Rylands* (n 751).
[769] *Read v Lyons* [1945] KB 216, 236.
[770] See, *St Helen's* (n 761) and *Hunter v Canary Wharf Ltd* [1997] UKHL 14.
[771] *Sedleigh-Denfield v O' Callaghan et al* [1940] AC 880, 903 (Lord Wright).
[772] Some examples of smells and gases being categorised as a nuisance are: *Aldred's case*, 77 Eng Rep 816, 9 Co. Rep 576 (KB 1611); *Bliss v* Hall (1838) 4 Bing NC 183; Walter *v Selfe* (1852) 19 LTOS 308; *Bamford v Turnley* [1962] 3 B&S 67; *St Helen's* (n 761); and *Dennis v MoD* [2003] Env LR 34.
[773] *Solloway v Hampshire County Council* (1981) 79 LGR 449.

vibrations,[774] water pollution[775] and flooding,[776] oil pollution,[777] and damage by both dust[778] and silt,[779] etc.[780] It is worth mentioning here that two recent decisions concerning group litigation for substantial and unreasonable interference with property may have established a precedent for further group actions to be taken in private nuisance.[781] Private nuisance has also recently been considered in the *Coventry v Lawrence* (2014) case,[782] which is discussed in the common law remedies section later on in this chapter.[783] It is necessary to look at the areas of nuisance that may become a concern for lenders during their loan financing. This section focuses primarily on the liability that can be incurred under the triggers of 'causing', and 'continuing' and 'adopting' a nuisance.

With regards to causing a nuisance, the activity creating the nuisance needs to be unreasonable, and interfere with a person's interest to land.[784] Damage to land is an important consideration for the court to assess when determining the land's reasonableness of use.[785] The damage in question must affect a proprietary interest to

[774] *Rushmer v Polsue & Alfieri Ltd* (1906) Ch D 234); and *Halsey v Esso Petroleum* [1961] 1 WLR 683.
[775] *Cambridge Water* (n 765).
[776] *Marcic v Thames Water Utilities Ltd.* [2003] UKHL 66.
[777] *Halsey* (n 774) 683.
[778] *Hunter* (n 770) 14.
[779] *Jan de Nul Products UK (Ltd) v AXA Royal Belge SA* [2002] 1 Lloyd's Rep. 583.
[780] Rogers (n 759), ch 14.
[781] *Barr & Ors v Biffa Waste Services* (2011) EWHC 1003 (TCC); (2012) EWCA Civ 312; and *Anslow v Norton Aluminium Ltd* (2012) EWHC 2610. See also, R Lee, 'Barr v Biffa Waste Services Ltd – Environmental permits as a defence in nuisance (*Eric-group*, 13 September 2011) <http://www.ericgroup.co.uk/environmental_regulation_story.php?content_id=265> accessed 12 June 2013.
[782] *Coventry (t/a RDC Promotions) v Lawrence* [2011] EWHC 360 (QB); [2012] EWCA Civ 26; [2014] UKSC 13; [2014] UKSC 46.
[783] infra, pg 149.
[784] *Read* (n 769) 236.
[785] *Merlin v British Nuclear Fuels plc* [1990] 2 QB 557; *Blue Circle Industries plc v Ministry of Defence* [1998] 2 All ER 385; and *Magnohard Ltd v United Kingdom Atomic Energy Authority (UKAEA)* [2004] Env LR 19. See also, *Coventry and others (Respondents) v Lawrence and another (Appellants)* [2014] UKSC 13 (Lord Neuberger).

the land,[786] and, when making its determination, the court will take the character and locality of the area, in which the interference takes place, into consideration. In *St Helen's Smelting Company v William Tipping* [1865] UKHL J81,[787] Lord Westbury LC suggested that a nuisance is dependent 'greatly on the circumstances of the place where the thing complained of actually occurs.' [788] Similarly, in *Sturges v Bridgman* (1879) LR 11 Ch D 852[789] the court held that the locality's particular character can be taken into account when deciding whether activities on the land are "reasonable". Thesiger LJ famously said that, 'What would be a Nuisance in Belgravia Square would not necessarily be so in Bermondsey.'[790] As well as the locality in which the nuisance takes place, judicial reasoning has also shown that the extent and duration of a nuisance are also relevant. Consequently the duration of the interfering event must be continual in its effect; [791] however there have been exceptions to this general requirement.[792]

It is highly unlikely that a lender would be found liable for actually causing a nuisance; this is because of the banks' distant role as a loan financier. Lender liability may, however, attach to a lender that 'continues' or 'adopts' a nuisance. For example, liability may materialise for a lender that owns or occupies property that creates a nuisance. In a nuisance related action, the law states that it is the occupier's duty to protect their land from interfering with neighbouring properties. This is an axiom based upon the principle outlined in the case of *Leakey and Others v National Trust for Places*

[786] *Read* (n 763); *Malone v Laskey* [1907] 2 KB 141; *Hunter* (n 770) 684; cf. *Khorasandjian v Bush* [1993] QB 727.
[787] *St Helen's* (n 761) 81.
[788] ibid (Lord Westbury LC). cf *Rushmer* (n 774); and *Coventry* 2014 (n 785).
[789] *Sturges v Bridgman* (1879) LR 11 Ch D 852.
[790] ibid (Thesiger LJ).
[791] See *Bolton v Stone* [1951] 1 All ER 1078; and *De Keyser's Royal Hotel v Spicer Bros. Ltd* (1914) 30 TLR 257).
[792] See *British Celenese Ltd v AH Hunt (Capacitors)* (1969) 2 All ER 1253; *Thompson-Schwab v Costaki* [1956] 1 All ER 652; and *Colour Quest Ltd v Total Downstream UK plc* [2009] EWHC 540 (Comm).

of Historic Interest or Natural Beauty [1980] QB 485.[793] In *Leakey*, the National Trust (i.e. the landowner) knew that their land, a large mound, was unstable and threatened neighbouring properties.[794] The neighbours alerted the landowner to the danger, following a number of minor falls.[795] It did not take responsibility for the land, and, after a dry summer, a large land slide occurred, causing damage to the neighbouring properties.[796] Proceedings were brought in nuisance for an order for abatement and damages.[797] The Court of Appeal held that an owner or occupier has a duty 'to do that which is reasonable[798] in all the circumstances'[799] to prevent the risk of injury or damage.[800] Megaw LJ stated, 'On the facts of the present case, the defendants had knowledge. They failed to take reasonable steps to bring the nuisance to an end.'[801]

Case law has shown that the Leakey principle can apply to flooding caused by the natural movement of water, and that a person's responsibility for preventing flooding is of a continuous nature.[802] As a result of the Leakey principle, the historic attitude towards flooding has now changed. In accordance with land drainage rights it is generally accepted that a person upon higher ground has no duty to provide water to any properties situated below.[803] However, if a property upon higher ground

[793] *Leakey and Others v National Trust for Places of Historic Interest or Natural Beauty* [1980] QB 485. Affirmed by the Privy Council's decision in *Goldman v Hargrave* [1967] AC 645.
[794] ibid, 485.
[795] ibid.
[796] ibid.
[797] ibid, 486.
[798] For further reference to what the judiciary have determined as "reasonable" within all the circumstances, see, *Wandsworth London Borough Council v Railtrack plc* [2001] Env LR 441; *Green v Somerleton* [2003] EWCA Civ 198; and *Marcic* (n 776) 25.
[799] *Leakey* (n 793) 524 (Megaw LJ) and *Goldman* (n 793). See also, Bell, McGillivray and Pedersen (n 28) 372.
[800] *Leakey* (n 793) 489.
[801] ibid, 498.
[802] See, *Pemberton v Bright* [1960] 1 All ER 792; and *Bybrook Barn Garden Centre Ltd v Kent County Council* [2001] BLR 55
[803] M Barlow, 'Legal Responsibility for Flooding' (4th CIWEM Annual Conference "Emerging Environmental Issues and Future Challenges", 12-14 Sept 2006).

'intentionally' or 'unreasonably' causes flooding to the lower plains, the owner(s) of the land will be unable to apply the *common enemy principle*, and could be made liable under the Leakey principle through an action in private nuisance.[804] Cole defines the *common enemy principle* or rule as, 'Specifically, the common enemy doctrine permits landowners to alter surface water flows with impunity for resulting damages to neighbouring properties.'[805]

The *Leakey* principle leads to the so-called 'measured duty of care' rule, which originates from the case of *Goldman v Hargrave* [1967] AC 645.[806] This rule refers to the situation where an owner of property has not caused the nuisance, but, nonetheless, has knowledge[807] of it, and fails to do all that is reasonable in order to abate it.[808] Owners and occupiers of land have a duty to keep their property in a way that it will not harm others.[809] In the opening paragraph of *Sedleigh Denfield v O'Callaghan* [1940] AC 880,[810] it states that:

> 'An occupier of land 'continues' a nuisance if, with knowledge or presumed knowledge of its existence, he fails to take reasonable means to bring it to

[804] See, *Whalley v Lancashire and Yorkshire Railway Co* (1884) 7 CB 515; and *Greenock Corp. v Caledonian Railway Co* [1917] AC 556.
[805] DH Cole, 'Liability Rules For Surface Water Drainage: A Simple Economic Analysis' (1990) 12(1) Geo Mason UL Rev 35 <http://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1863&context=facpub> accessed 11 June 2014. For a UK case relating to this issue, see, *Arscott v The Coal Authority* [2005] Env L Rev 6, 27.
[806] *Goldman* (n 793).
[807] cf the dissenting judgment in *Job Edwards Ltd v The Company of Proprietors of the Birmingham Navigations* [1924] 1 KB 341, 353-362 (Scrutton LJ).
[808] D Quinn, 'Measuring the "measured duty" in a nuisance claim' (*Lyons Davidson Solicitors*, 14 November 2012) <http://www.lyonsdavidson.co.uk/news/3555/measuring-the-measured-duty> accessed 20 November 2013.
[809] *Leakey* (n 793); *Holbeck Hall Hotel v Scarborough Borough Council* [2000] 2 All ER 705.
[810] *Sedleigh-Denfield* (n 771) 880.

> an end when he has ample time to do so; and he 'adopts' it if he makes any use of the erection or artificial structure which constitutes the nuisance.' [811]

In *Sedleigh's* case, a trespasser placed a pipe for carrying off rainwater upon an occupier's land without their knowledge or consent.[812] However, the occupier of the land became aware of the pipe through their servants.[813] On becoming aware of its existence, the occupier continued to use the pipe, and a grill was fitted to prevent leaves blocking the conduit during times of heavy rainfall.[814] Subsequently, the grill caused a blockage, and allowed the inundation of water upon a neighbour's property.[815] The House of Lords held that the respondents had knowledge of the pipe on their land, and were responsible for the damage caused.[816] Lord Atkin stated that, 'It seems to me clear that if a man permits an offensive thing on his premises to continue to offend, that is if he knows that it is operating offensively, is able to prevent it and omits to prevent it he is permitting the nuisance to continue; in other words he is continuing it.'[817] The *ratio* in *Sedleigh Denfield* was recently followed in the case of *Octavia Hill Housing Trust v Brumby* [2010] EWHC 1793 (QB).[818] In that case Mackay J allowed a claim in nuisance against a landlord that possessed a constructive knowledge of nuisance and failed to abate the interference from occurring.[819]

[811] ibid.
[812] ibid.
[813] ibid.
[814] ibid.
[815] ibid.
[816] ibid, para 897 (Lord Atkin).
[817] ibid.
[818] *Octavia Hill Housing Trust v Brumby* [2010] EWHC 1793 (QB) (Mackay J).
[819] ibid, para 16 (Mackay J).

In the environmental context, the measured duty rule was considered in the case of *Anthony and Others v The Coal Authority* [2005] EWHC 1654 (QB).[820] *Anthony* concerned a burning coal tip, which was ablaze for a period of three years, and unreasonably affected a neighbouring community's use and enjoyment of their land, as well as reducing visibility on the M4 motorway.[821] The court in *Anthony* held that the Coal Authority had 'failed in the circumstances to take reasonable steps to abate the nuisance',[822] and was liable in private nuisance.[823] Case law concerning the measured duty of care may be especially relevant for lenders, because it is possible for a bank to own suspect land that causes interference with neighbouring properties. Even if the bank did not create the nuisance that causes the interference, if it has knowledge of the harm that has or is being caused, and has taken possession of the property, it has a duty to reasonably prevent or abate the nuisance, or face liability by being in breach of the measured duty rule. Similarly, where an injunction to abate a nuisance and/or an order for damages is served on a company who has a loan from a bank, indirect and reputational risks may be created for the lender. For instance, an injunction may restrict a borrower's business operations etc., resulting in credit risk for the bank (see 'Common Law Remedies' section).

2. Public Nuisance

[820] *Anthony and Ors v The Coal Authority* [2005] EWHC 1654 (QB).
[821] ibid, paras 2-8 (Pitchford J). For an overview of this case, see: R Lee, 'Case Study – Brynlliw Colliery: Anthony & Ors v Coal Authority' (*Eric-group*, no date) <http://www.environmentlaw.org.uk/rte.asp?id=44> accessed 20 November 2013. See also, 'Families win fire tip legal fight' (*BBC News*, 11 August 2005) <http://news.bbc.co.uk/1/hi/wales/south_west/4141926.stm> accessed 20 November 2013.
[822] *Anthony* (n 820), para 162 (Pitchford J).
[823] ibid, paras 163-167 (Pitchford J).

Public nuisance can exist as both a criminal offence[824] brought under a relator action by the Attorney General, or as a tort action by a number of individuals who have suffered damage. The standard definition of a public nuisance can be found in the judgments of Romer and Denning LLJs in the case of the *Attorney-General v PYA Quarries* [1957] 2 QB 169. Denning LJ, as he was then called, suggested that:

> 'The classic statement of the difference is that a public nuisance affects Her Majesty's subjects generally, whereas a private nuisance only affects particular individuals … [and] … is so widespread in its range or so indiscriminate in its effect that it would not be reasonable to expect one person to take proceedings on his own responsibility to put a stop to it, but that it should be taken on the responsibility of the community at large.'[825]

Public nuisance can allow liability to be allocated even where the claimant has no private right to the land. It is noteworthy that in the *Corby Litigation* case, whether a person with no legal right to the land could be made liable was a point that was left open by the court in an action preliminary to the main case.[826] As with private nuisance, in order for a claim to be actionable in public nuisance, the damage must be 'reasonably

[824] Archbold, *Criminal Pleading, Evidence and Practice* (Sweet and Maxwell, London 2012) ch 31, para 31-40:'Public nuisance is an offence at common law. A person is guilty of a public nuisance (also known as common nuisance), who (a) does an act not warranted by law, or (b) omits to discharge a legal duty, if the effect of the act or omission is to endanger the life, health, property, or comfort of the public, or to obstruct the public in the exercise or enjoyment of rights common to all Her Majesty's subjects.'
[825] *Attorney-General v PYA Quarries* [1957] 2 QB 169, 190-191 (Denning LJ). However, see the opinion, albeit *obiter*, of Lord Roger in *R v Rimmington; R v Goldstein* [2005] UKHL 63, para 44 (Lord Roger).
[826] *Corby Group Litigation* (n 347). See also, *Tate & Lyle v Greater London Council* [1983] 2 AC 509.

foreseeable'.[827] A great deal of uncertainty surrounds this tortious action,[828] and the necessity of its future use has therefore been brought into question.[829]

It is very unlikely that a bank would incur liability in public nuisance. Nevertheless, if a bank forecloses upon its securities, it may be held liable for continuing or adopting a public nuisance as a mortgagee in possession. It may be possible (and this also applies to private nuisance) for lender liability to transfer to the mortgagee when allowing equity of redemption,[830] and, instead of physically foreclosing the property, rent is collected as a form of repayment for the loan. However, in order for this to happen, the mortgagee must have a significant degree of participation in its mortgagor's business affairs. Environment-related risks for lenders are far more likely to occur in the situation where the borrower's business efficacy is impacted by a court order etc., and the bank suffers exposure from indirect and reputational risks as a consequence.

3. The Rule in *Rylands v Fletcher*

The rule in *Rylands v Fletcher* is a part of nuisance.[831] As with continuing or adopting a nuisance under the *Leakey* principle, the rule in *Rylands v Fletcher* may also create lender liability for a mortgagee in possession of land that causes damage to surrounding property. In the case of *Rylands* the defendant commissioned the construction of a

[827] *The Wagon Mound No 1* [1961] AC 388 and *Cambridge Water* (n 765). See also, C Gearty, 'The Place of Private Nuisance in a Modern Law of Torts' (1989) 48(2) CJL 214.
[828] J Pointing, 'Beyond Highway 61 Revisited?' (2011) 13(1) *Env L Rev* 25.
[829] JR Spencer, 'Public Nuisance – A Critical Examination' (1989) CLJ 55; and *R v Rimmington; R v Goldstein* [2005] UKHL 63.
[830] Martin (n 514) 167. 'Equity of Redemption' is defined as: 'The rights of a mortgagor over his mortgaged property, particularly the right to redeem the property. This right of redemption allows a mortgagor to redeem the mortgaged property at any time on payment of principal, interest, and costs, even after the contractual date of redemption, as stated in the mortgaged deed, has passed.'
[831] *Fletcher v Rylands and Horrocks* (1865) 159 ER 737.

reservoir on their land for the storage and keeping of water.[832] A competent engineer, and competent contractors, were employed to carry out the work.[833] Upon excavating the land, five vertical mine shafts were discovered at the base of the dam.[834] The contractors filled the shafts with the surrounding soil, as neither the defendant, nor the contractors, had knowledge that the shafts led to old coal workings, which entered into a neighbour's colliery.[835] When water was released into the dam, it escaped down one of the mineshafts, and, 'by means of the underground communications, into the plaintiff's colliery, and flooded it.'[836] In the first instance, the court ruled that the defendant was not liable for the damage caused to the neighbour's property.[837] This decision was reversed on appeal. In his judgment Blackburn J[838] suggested:

> 'We think that the true rule of law is, that the person who for his own purposes brings on his lands and collects and keeps[839] there anything likely to do mischief to if it escapes,[840] must keep it in at his peril, and, if he does not do so, is prima facie answerable for all the damage which is the natural consequence[841] of its escape.'[842]

On further appeal to the House of Lords, the decision in the Court of the Exchequer Chamber was affirmed.[843] Later judicial reasoning, however, has emphasised that in

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[832] ibid.
[833] ibid.
[834] ibid.
[835] ibid.
[836] ibid.
[837] ibid.
[838] *Rylands v Fletcher and Another* (1865-66) LR 1 Ex 265, 279 (Blackburn J).
[839] *Giles v Walker* [1890] 24 QBD 656.
[840] *Ponting v Noakes* (1849) 2 QB 281.
[841] *Transco plc v Stockport Metropolitan Borough Council* [2003] UKHL 61, para 9 (Lord Bingham).
[842] *Rylands* (n 838) 279 (Blackburn J).
[843] *Rylands* (n 751) 340 (Lord Cairns). Lord Cairns suggested that, 'My Lords, in that opinion, I must say I entirely concur. Therefore, I have to move your Lordships that the judgment of the Court of Exchequer Chamber be affirmed, and that the present appeal be dismissed with costs.'

order for a claim under the rule in *Rylands* to succeed, it must be shown that that there was a 'non-natural' use of the land,[844] which must also be 'extraordinary' in its effect.[845] But, the rule in *Rylands* is unlikely to create lender liability for the bank that provides financial assistance. That being said, if a mortgagee is in possession of land which 'collects and keeps anything there that is likely to do mischief', and an escape occurs, damaging neighbouring property, in theory lender liability may materialise. However, this is unlikely to happen in practice. Indeed, case law concerning *Rylands'* application has invoked discussion as to whether the rule still serves as useful purpose. For example, in *Transco plc v Stockport Metropolitan Borough Council* [2003] UKHL 61,[846] the House of Lords held that water which leaked from an underground gas pipe, accumulated, and caused an embankment to slip, was not deemed to be an 'extraordinary event' capable of invoking the rule's use. In *Transco*, Lord Bingham stated that, while it was necessary to retain the rule in *Rylands*, its application has nevertheless been reduced over the last few years.[847] The case of *Stannard (t/a Wyvern Tyres) v Gore* [2012] EWCA Civ 1248[848] concerned the accidental spread of fire, which subsequently caused damage to a neighbour's property. At paragraph 53 of his judgment, Etherton LJ suggested that:

> 'Firstly, in the light of the comprehensive review of the *Rylands v Fletcher* principle in *Transco plc v Stockport MBC* [2003] UKHL 61, [2004] 2 AC 251, I do not consider that the facts of the present case satisfy the basic requirement of the *Rylands v Fletcher* principle that there must

[844] *Transco plc v Stockport MBC* (n 835)
[845] *Rickards v Lothian* [1913] AC 263; and *Transco* (n 835).
[846] *Transco plc v Stockport MBC* (n 835).
[847] ibid, para 13.
[848] *Stannard (t/a Wyvern Tyres) v Gore* [2012] EWCA Civ 1248.

> have been an escape of something which the defendant has brought onto his or her land.'[849]

Therefore, like private and public nuisance, if *Rylands* is going to affect a bank, it is most likely going to be through the impact that it has to a client, and the indirect and reputational risks that are created for the mortgagee, to which the mortgage money is owed.

B. Negligence

Nuisance is the tort that is most commonly used to remedy environmental issues. In the alternative to nuisance, it may be possible to make a claim in negligence. Negligence is very rarely used over nuisance in environmental claims; on the other hand, Jarvis and Fordham suggest that negligence, 'can readily be treated as an avenue for civil liability supplemental to nuisance and *Rylands v Fletcher*.'[850] It therefore bears relevance within this chapter.

The modern tort of negligence is thought to have been created by Lord Atkin's 'neighbour principle', which was developed in the case of *Donoghue v Stevenson* [1932] AC 562.[851] In that case Lord Atkin opined:

> 'The rule that you are to love your neighbour becomes in law you must not injure your neighbour; and the lawyer's question "Who is my neighbour?" receives a restricted reply. You must take reasonable care to avoid acts or

[849] ibid, para 53 (Etherton LJ). See also the decision of Ward LJ at paras 22 and 23.
[850] Jarvis and Fordham (n 51) 38.
[851] *Donoghue v Stevenson* [1932] AC 562; cf *Caparo Industries v Dickman* [1990] 1 All ER 568.

> omissions which you can reasonably foresee would be likely to injure your neighbour.'[852]

When establishing legal causation, it must first be proven that the tortfeasor has breached a duty owed to the claimant, and 'but for' the defendant's actions the damage would not have materialised.[853] This is commonly known as 'the chain of causation'. The chain of causation may be broken by a *novus actus interveniens* ('new intervening act'); and an intervening act is assessed by a test of foreseeability. The chain of causation can also be established where two or more successive or concurrent causes enable a claim in negligence for a material contribution to the injury[854] or risk.[855] This has been shown in a number of cases concerning work related injuries, which are caused by employers' unreasonable protection of their employees from harmful substances, like asbestos.[856]

Establishing a causal link for an environmental claim in negligence is a difficult prospect.[857] And a mortgagee would not incur lender liability unless it actively participates in its mortgagor's business, or was a mortgagee in possession of property, that breached the duty of care owed to others. Much more likely are the indirect and reputational risks for the bank, being triggered by a mortgagor's negligent conduct. For instance, a borrower that is ordered to pay damages to injured claimants in negligence

[852] ibid, 580 (Lord Atkin).
[853] *Barnett v Chelsea and Kensington Hospital* [1969] 1 QB 428.
[854] *Bonnington Castings Ltd v Wardlaw* [1959] AC 613.
[855] *McGee v National Coal Board* [1979] 3 All ER 1008; *Fairchild v Glenhaven Funeral Services* [2002] 3 WLR 89; and *Barker v Corus (UK) plc* [2006] UKHL 20.
[856] *Fairchild* (n 849) 89
[857] However, see the case of *Corby Group Litigation* (n 347), where the court found a causal link between a local authority's negligence remediation techniques and the birth defects amongst the children within the residential community. For a good journal paper concerning this case, see, R Lee, 'Old iron: birth defects and the Corby steelworks' reclamation' (2009) 25 PN 174.

may default on the mortgage repayment, resulting in credit risk for the bank. Also, reputational risk can be significant. Persons that injure others as a result of negligent conduct often receive widespread public scrutiny. A bank associated with such persons may also be subject to negative press.

C. Common Law Remedies

There are two primary remedies in the common law. First, a claimant may wish to procure an injunction that the interfering activity be stopped.[858] This type of remedy is more likely to occur within a nuisance related claim.[859] Wade and Forsyth suggest that, 'The injunction is the standard remedy of private law for forbidding the commission of some unlawful act e.g. a tort or breach of contract.'[860] If a borrower is served with an injunction which limits its capacity to operate efficiently, it is more likely that credit risk will materialise for the bank. Secondly, an order may be made for the recompense of any damages that were made *ex delicto*.[861] Case law has shown that damages can be assessed for any direct harm to the property caused by the nuisance.[862] While the accuracy of assessing damages for property is questionable, a diminution in the property's value will nevertheless be considered when evaluating *quantum*.[863] A borrower that is forced to pay damages is a credit risk for the bank to which money is owed.

[858] W Wade and C Forsyth, *Administrative Law* (10th edn, OUP 2010) 474.
[859] ibid.
[860] ibid.
[861] *Shelfer v City of London Electric Lighting Co*. [1895] 1 Ch 287; *Anslow* (n 781) (McKenna J); and *Coventry* 2014 (n 785).
[862] For instance, see the contrasting decisions of the courts in the following cases: *Blue Circle* (n 785) 385; and *Magnohard* (n 785) 19.
[863] *Hunter* (n 770) 684.

The ability to award damages instead of an injunction was recently considered, *inter alia*, in the case of *Coventry (t/a RDC Promotions) v Lawrence* [2011] EWHC 360 (QB); [2012] EWCA Civ 26; [2014] UKSC 13; [2014] UKSC 46.[864] In this case, the court had to determine whether motor sports activities had created noise nuisance, notwithstanding the fact that the activities had received permission from the planning authority, and that the interference was caused by the claimant coming to the nuisance. More specifically, in 1975 C was granted planning permission to build a motor sports stadium. Further to this, a certificate of lawful use was issued for stock car racing in 1997. M also leased a nearby track (situated at the rear of the stadium) for motor sports and in 1992 temporary planning permission was granted. M received permanent planning permission in 2002, although this was subject to limitations. In 2006 L bought a residential property close to the motor sports arena. In December 2007 an abatement notice was served following an investigation by the local council. The abatement works were subsequently completed in January 2009. Another notice was served in August 2009. Proceedings were issued by L, claiming that a noise related nuisance had been created by C and M. However, C and M argued that there was no nuisance because of the grant of planning permission and that the character of the locality had changed because of their activities.

In the High Court, Seymour J issued an injunction that the activity generating the noise be restricted to designated levels at permitted hours of the day.[865] However, the injunction was stayed as the appellants' house had been badly damaged in a fire.[866] C

[864] *Coventry* (n 782). In fact this case covered a number of important aspects surrounding nuisance law, including acquiring the right to commit a nuisance through prescription, the defence of "coming to a nuisance", locality and the relevance of planning permission.
[865] *Coventry (t/a RDC Promotions) v Lawrence* [2011] EWHC 360 (QB), para 245 (Seymour J).
[866] ibid.

and M appealed the High Court's decision, which was reversed by Jackson LJ in the Court of Appeal.[867] In the Supreme Court[868] L's appeal was allowed in a unanimous decision that was led by Lord Neuberger. Amongst other things, their Lordships determined, 'the approach to be adopted by a court when deciding whether to grant an injunction to restrain a nuisance being committed, or whether to award damages instead, and the relevance of planning permission to that issue.'[869] In relation to this particular legal issue, the court held that the 'mechanical application'[870] of the four tests for the award of damages laid down by A L Smith LJ in *Shelfer v City of London Electric Lighting Co*. [1895] 1 Ch 287[871] was wrong in principle.[872] Lord Neuberger, who gave the leading judgment in this case, suggested that, 'The court's power to award damages *in lieu* of an injunction involves a classic exercise of discretion, which should not, as a matter of principle, be fettered.'[873] Also, it was held that a court may refuse an injunction where planning permission authorises an activity.[874] The court decided that a nuisance existed,[875] and the respondents had not acquired a right to commit nuisance by prescription.[876] The Supreme Court restored the previous order for a noise-limiting injunction by Seymour J.[877] Damages were also awarded under the High Court's order;[878] the order directed C and M to pay sixty per cent of L's costs.[879] The Supreme Court's judgment is significant because it may indeed remove the courts' mechanical application to the award of damages *in lieu* of an injunction, clearing the way for a more

[867] *Coventry (t/a RDC Promotions) v Lawrence* [2012] EWCA Civ 26, para 76 (Jackson LJ).
[868] *Coventry* 2014 (n 785).
[869] ibid, para 6.
[870] ibid, para 119.
[871] *Shelfer* (n 861) 287 (AL Smith LJ).
[872] *Coventry* 2014 (n 785), para 119 (Lord Neuberger).
[873] ibid, para 120.
[874] ibid, para 125.
[875] ibid, para 6.
[876] ibid, para 143.
[877] ibid, para 148.
[878] ibid, paras 151-152.
[879] ibid.

'flexible' approach.[880] To clarify some of the issues arising from the Supreme Court's decision, a further judgment was handed down by the Supreme Court in *Coventry and others (Respondents) v Lawrence and another (Appellants)* [2014] UKSC 46. There were four issues that the Supreme Court had to address.[881] The court ruled that the injunction should not take effect until the residential property is restored,[882] and that there should be a delay before the parties can apply to vary the injunction.[883] The Supreme Court also had to determine whether the landlord was also liable to the appellants in nuisance.[884] Lord Neuberger held that in order for a claim against the landlord to succeed, 'it must be based on their 'active' or 'direct' participation.'[885] In this case Lord Neuberger (with whom Lord Clarke and Lord Sumption agreed) did not consider the landlord to have 'authorised' or 'participated' in the nuisance.[886] Nevertheless, the potential for landlords to incur liability in nuisance is interesting. A bank may be considered a 'landlord' if a mortgagor defaults on its loan repayment, and the mortgagee requests the receipt of rents (instead of physical foreclosure) as a form of repayment. If, during the course of the repayment, the mortgagor creates a nuisance, and the mortgagee is deemed to have authorised the activity that created the nuisance through its degree of control over the mortgagor, liability could be transferred to the bank in nuisance. The fourth issue for the court to address was whether the level of the

[880] R Biela and S Moore, 'Coventry v Lawrence: more flexibility about awarding damages over an injunction' (*Nabarro*, 25 March 2014) <http://www.nabarro.com/insight/briefings/2014/march/coventry-v-lawrence-more-flexibility-about-awarding-damages-over-an-injunction/> accessed 1 June 2014. For a good summary of the case, see also, 'The Supreme Court Makes Fundamental Changes To The Laws Of Nuisance' (*Burges Salmon*, March 2014) < http://www.burges-salmon.com/practices/environment/environmental_litigation/publications/fundamental_change_to_law_of_nuisance_coventry_v_lawrence.pdf> accessed 1 June 2014.

[881] *Coventry and others (Respondents) v Lawrence and another (Appellants)* [2014] UKSC 46, paras 3-4 (Lord Neuberger).

[882] ibid, paras 6-7.

[883] ibid, para 8.

[884] ibid, para 15.

[885] ibid, para 18.

[886] ibid, para 30 (Lord Neuberger); cf para 66, 69 (Lord Carnwarth, with whom Lord Mance agreed).

costs that the judge's order required the respondents to pay (i.e. sixty per cent of the appellants' costs) infringed the right to a fair trial under article 6 of the European Convention on Human Rights (ECHR).[887] Lord Neuberger suggested that the case should be re-listed, as, in light of the Strasbourg court judgments, 'it may be that the respondents are right in their contention that their liability for costs.'[888]

Now that the common law has been assessed, the next section outlines different statutory sources of law that may create environment-related risks for lenders who own, or have borrowers that own, suspect land.

II. Statute

This section begins by looking at the liability regime under the Environmental Damage (Prevention and Remediation) Regulations 2009.[889]

A. Directive 2004/35/EC as transposed by the Environmental Damage (Prevention and Remediation) Regulations 2009

A lender may be capable of incurring liability as an 'operator' or 'owner' of land under Directive 2004/35/EC[890] (hereafter, 'the Environmental Liability Directive', 'the Directive' or, more colloquially, 'the ELD'), which was transposed into England on 1

[887] ibid, para 38.
[888] ibid, para 41.
[889] Directive 2004/35/EC of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage.
[890] ibid.

March 2009.[891] The ELD's transposing legislation, the Environmental Damage (Prevention and Remediation) Regulations (EDR) 2009,[892] are considered in this section. The ELD's primary purpose is to establish a European-wide framework of liability based on the *polluter pays principle*.[893] This framework is designed to prevent and remedy the occurrence of any 'environmental damage'[894] caused by operators' occupational activities[895] throughout the EU.[896] The ELD states that 'damage' means, 'a measurable adverse change in a natural resource or measurable impairment of a natural resource service which may occur directly or indirectly.'[897] According to article 2(6) an 'operator' is:

> 'any natural or legal, private or public person who operates or controls the occupational activity or, where this is provided for in national legislation, to whom decisive economic power over the technical functioning of such an activity has been delegated, including the holder of a permit or authorisation for such an activity or the person registering or notifying such an activity.'[898]

If a borrower's operation is capable of being categorised as an 'occupation activity'[899] under the ELD, this should trigger the lenders' use of environmental due diligence. 'Occupational activity' is defined as, 'any activity carried out in the course of an

[891] Environmental Damage (Prevention and Remediation) Regulations (EDR) 2009, SI 2009/153, reg 1(1).
[892] ibid.
[893] Directive 2004/35/EC, art 1.
[894] ibid, art 2(1)(a)-(c): 'environmental damage' includes damage done to protected species and natural habitats, water resources and land.
[895] ibid, art 2(7); EDR 2009, reg 2(1).
[896] ibid, art 1.
[897] ibid, art 2(2).
[898] ibid, art 2(6); EDR 2009, reg 2(1).
[899] ibid, art 2(7).

economic activity, a business or an undertaking, irrespectively of its private or public, profit or non-profit character.'[900] The scope of the ELD's liability is dependent upon the type of occupational activity that creates damage, or the threat of damage.[901] Liability can be determined strictly,[902] or by an assessment of an operator's fault or negligence.[903] The ELD's liability also applies to 'multiple party causation'.[904] There are two types of operational activity under the ELD:

- If the occupational activity is classified as 'dangerous' and is therefore listed as an Annex III operation, the liability scheme is applied strictly.[905] Activities referred to in Annex III include such things as a waste management operation subject to licence or registration,[906] all discharges into the inland surface water requiring prior authorisation,[907] all discharges of substances into groundwater which require prior authorisation,[908] etc.[909] Borrowers working in annexed operations must be closely monitored by banks.[910]

- Alternatively, if an occupation is not listed within Annex III an operator may still incur liability.[911] In that situation the assessment of damage will be based

[900] ibid.
[901] ibid, art 3.
[902] ibid, art 3(1)(a).
[903] ibid, art 3(1)(b).
[904] ibid, art 9.
[905] ibid, art 3(1)(a).
[906] ibid, ann 3(2).
[907] ibid, ann 3(3).
[908] ibid, ann 3(4).
[909] See also, EDR 2009, sch 2.
[910] e.g. the IPPC Directive.
[911] Directive 2004/35/EC, art 3(1)(b).

> upon an analysis of the operator's fault or negligence in relation to the damage to protected species and natural habitats or the imminent threat of damage.[912]

In relation to the UK, 'environmental damage' includes damage to: (1) protected species or natural habitats,[913] or a site of special scientific interest;[914] (2) surface or groundwater;[915] or (3) land.[916] The 'enforcing authorities' are enforced either under the Environmental Permitting (England and Wales) Regulations 2007, if the damage is caused by an installation etc. requiring an environmental permit;[917] or, if such a permit is not required, an enforcing authority is an authority listed in the table at Regulation 11 of the Environmental Damage Regulations 2009.[918] 'Operators' may be liable to take preventative action where environmental damage has not occurred, but there is an imminent threat of such damage.[919] In this case the operator must 'take all practical steps to prevent the damage',[920] and 'notify all relevant details to the enforcing authority'.[921] The ELD has a number of enforcement provisions which are, what Fogleman describes as, 'self-executing'. She explains that this means that they, 'impose a direct duty on an operator not only to notify a competent authority of the imminent threat of, or actual, damage but also to carry out preventive or remedial works.' The enforcing authority may serve a remediation notice[922] on the operator.[923] On the other hand, action may be taken by the enforcing authority instead of the operator.[924] Where

[912] ibid.
[913] EDR 2009, reg 2(1) defines 'natural habitat'.
[914] ibid, reg 4(1)(a); sch 1.
[915] ibid, reg 4(1)(b) and (4); reg 2(1) defines 'groundwater'.
[916] ibid, reg 4(1)(c) and (5).
[917] ibid, reg 10.
[918] ibid, reg 11.
[919] Directive 2004/35/EC, art 5(1); EDR 2009, regs 13-16.
[920] EDR 2009, reg 13(1)(a).
[921] ibid, reg 13(1)(b).
[922] ibid, reg 20.
[923] ibid, reg 13(2).
[924] ibid, reg 15(a)-(c) and reg 23.

environmental damage has already occurred, remedial action is therefore necessary.[925] It is for the enforcing authority to decide whether 'environmental damage' has occurred.[926] According to regulation 27, the enforcing authority may also recover costs, by way of a charge on the premises, from a person who is the 'owner'[927] of the premises.[928] A person who receives a notice reserves the right to appeal against the notification of the liability to remediate,[929] or to the notification of the remediation notice,[930] to the Secretary of State. An operator served with a remediation notice has a period of twenty-eight days from when it was first served to appeal the decision.[931] The procedure for appeal is outlined in Schedule 5 of the 2009 Regulations.[932] Regulation 21(5) says that the appeal may be approved, quashed or varied by the Secretary of State or the relevant appointed person, and the final decision must be notified to the operator in writing.[933] A person guilty of an offence upon summary conviction may incur a fine not exceeding the statutory maximum, or a term of imprisonment not exceeding three months, or both.[934] On conviction in the Crown Court, a person found guilty can expect a fine, or a term of imprisonment for a maximum of two years, or both. A body corporate may also receive penalties where it is proven guilty of committing an offence. Regulation 34(2) states: 'Where a body corporate is guilty of an offence…and that offence is proved to have been committed with the consent or connivance of, or have been attributable to any neglect on the part of – (a) any director, manager, secretary or

[925] ibid, art 6(1); and pt 3.
[926] ibid, reg 17 and reg 21.
[927] ibid, reg 27(9).
[928] ibid, reg 27.
[929] ibid, reg 19.
[930] ibid, reg 21.
[931] ibid, reg 21.
[932] ibid, sch 5.
[933] ibid, reg 21(5).
[934] ibid, reg 34(1)(a).

other similar person; or (b) any person who was purporting to act in any such capacity.'[935]

When acting instead of the operator, the enforcing authority may recover all 'reasonable costs' incurred from the operator.[936] The framework for remediation is outlined in Annex II of the Directive. In accordance with the ELD, remediation can take a number of different forms. If the environmental damage has taken place on land, the remediation threshold requires the site be cleaned to such a degree that the site no longer has an adverse impact on human health.[937] Conversely, if the damage has occurred to water or protected species or habitats, the remediation threshold requires that the damage is remediated 'to its baseline condition.'[938] The ELD enforces three possible remediation objectives for damage to water or protected species or natural habitats. The remediation objectives that can be implemented include: primary remediation, complementary remediation and compensatory remediation.[939]

The European Commission's (EC's) 2010 Report[940] on the effectiveness of the regime took into account the transposition process during its deliberations. The EC's findings suggest that the ELD has been so far ineffective; and that the ELD's slow rate of transposition into Member States is evidence of this.[941] The allocation of liability under the ELD has proven difficult to determine in some cases of environmental damage.[942]

[935] ibid, reg 34(2).
[936] ibid, reg 24.
[937] Directive 2004/35/EC, Annex II.
[938] ibid, Annex II.
[939] ibid, s 1(a)-(d).
[940] Report from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, *Under Article 14(2) of Directive 2004/35/EC on the environmental liability with regard to the prevention and remedying of environmental damage* (COM 2010) 581.
[941] ibid, 4-5.
[942] P Cameron, 'Liability for catastrophic risk in the oil and gas industry' (2012) IELR 207.

And this is particularly so in relation to occupational activities affecting the marine environment e.g. oil works.[943] With regards to the ELD, Respondent 1 said:

> *R_1: I sat on the working group for the ELD and, again, it's like … well if you're in Spain you have to take out insurance because it's mandated, but in the UK … I mean … Well I'll ask you, how many cases have you come across where they've [banks] been taken to court?*
>
> *I: I can't think of one off hand!*
>
> *R_1: There you go! The thing was, we'd say, "How many sites do you think this is going to impact?" and I think it was sort of under 20, because it's a risk. And if you're one of those twenty you wish you had insurance, but when you're looking at it, does the bank put in the policy to impact all of our customers on the basis of this legislation? No! Because on a portfolio basis, where we deal with tens of thousands of properties a year, it's not a portfolio risk![944]*

Despite the ELD's slow transposition into the national legal frameworks of the European Member States,[945] the Directive has created risks for companies operating in certain areas. This section argues that the ELD has heightened the likelihood of banks incurring environment-related risks during their corporate financing. For example, Richardson believes that, while unlikely, lenders may incur liability as operators since

[943] ibid. In this article Cameron discusses the effect that the Macondo oil spill has had on various liability laws relating to marine protection.
[944] Interview with Respondent 1.
[945] Winter et al. (n 43) 175.

the ELD does not specifically exclude secured creditors from being held liable as an operator. He advises:

> 'It would appear that liability would extend to a lender only if it was considered by the authorities to be "a person that directs the operation or activity". This suggests a form of participation in the management of a business rather than merely having the formal capacity to influence operations.'[946]

In order for operator liability to attach to a lender, it would be necessary to show that the bank had 'participated in the management' of the borrower's business affairs. The degree of the bank's participation which is necessary to attract liability is yet uncertain. This may occur, for example, if the bank advises its client during its due diligence and thereby falls within the meaning of 'shadow director' as defined by section 251(1) of the Company Act 2006, i.e. 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act.'[947] The lender liability for environmental damage which occurred in America under the CERCLA regime showed that liability for environmental issues might materialise where a lender merely participates in the management or business affairs of one of its borrowers. This type of risk is different to liability for owning or occupying land, as liability may be apportioned without the bank's exercise of security over property. The primary consequence of being a shadow director is that the bank may be found liable as a

[946] Richardson, 'Environmental liability and banks' (n 54) 287.
[947] Company Act 2006, s 251(1). See also, Insolvency Act 1986, s 251; and Company Directors Disqualification Act 1986, s 22(5).

director of the company,[948] which is what O'Donovan describes as 'Lender Liability for Honest Intermeddling'.[949]

However, it must be remembered that while a bank may obtain a significant amount of control through its conduct of due diligence, liability is unlikely to occur simply by providing financial assistance and carrying out due diligence as a loan financier. Although the term 'owner' is referenced under the ELD, only the operator may be primarily liable for environmental damage. Nevertheless, pursuant to regulation 27 if the enforcing authority has paid to prevent or remediate the environmental damage, it may recover any costs incurred from the owner of the premises.[950] Therefore, the bank that has taken security, becoming a mortgagee in possession, could be made to pay the costs of remediating environmental damage as an owner of the premises.[951] According to the Environmental Damage Regulations 2009 an 'owner' means, 'a person (other than a mortgagee not in possession).'[952] For the enforcing authority to charge the remediation costs to a bank, it must be shown that the mortgagee holds a position of 'possession' over the premises. A bank that does not enforce its securities by physically foreclosing the property (i.e. a mortgagee not in possession) is not capable of being fixed with a charge for remediating environmental damage.[953]

As well as primary liability as an operator, or being charge with the costs of remediation as an owner (which are both unlikely to occur), there are also the indirect and reputational risks to think about. The ELD, and its transposing legislation, has placed

[948] *In re a Company (No 005009 of 1987), ex parte Copp and Another* [1989] BCLC 13, 20 (Knox J).
[949] O'Donovan (n 63) 488.
[950] EDR 2009, reg 27.
[951] ibid.
[952] ibid, reg 27(9).
[953] ibid.

increased pressure on businesses throughout Europe to report and clean-up environmental damage. If a customer of the bank is required to prevent or remediate environmental damage, the likelihood of the bank incurring credit and/or security risks inevitably increases. For instance, the borrower may default on its loan repayment or the value of the bank's secured assets may depreciate because of the damage. On top of that, being associated with a client whose operations are likely to cause or have caused environmental damage, could result in reputational harm by association for the bank. This links later discussion in Chapter 7, which analyses banks' environmental due diligence and high risk clients.[954]

It is noteworthy that because of the ELD banks may have a possible duty to report to the competent authority when charging land, where the due diligence suggests ongoing contamination. The above assertion is made because, although unlikely, banks can incur operator liability, as discussed above. Although the amount of control that is required to incur operator liability is uncertain, knowledge of environmental damage (or threat of) gathered from the conduct of due diligence may lead to the bank being classed as an operator, and liable for remediation costs. Reporting the environmental damage to the competent authority should act to reduce the bank's prospects of incurring primary liability under the ELD. When reporting, the bank must emphasise that its knowledge of the damage was generated through its ordinary and prudent exercise of due diligence, and that the bank is not a participant in its borrower's business. Bearing in mind the importance of corporate social responsibility in modern business practices, even if the bank is not classified as an operator, it is a question for moot whether it should still report any environmental issues that it finds during its due diligence. The problem with

[954] infra, ch 7, pg 290.

reporting is that it may not be in the best interest of banks, as this is likely to increase future credit and security risks. However, under some regulatory regimes, if a bank omits to report environmental incidents to the appropriate authorities, it could be held liable as a person that 'knowingly permitted' the pollution to take place.[955]

Following the discussion of the ELD, the next section looks at the Environmental Permitting (England and Wales) Regulations 2010.

B. Environmental Permitting (England and Wales) Regulations 2010

The environmental risks that lenders can incur have increased because of environmental licensing. The Environmental Permitting (England and Wales) Regulations 2010[956] consolidated a number of the previous licensing regimes for regulating environmentally harmful activities[957] into one e.g. Pollution Prevention and Control Regulations 2000,[958] Part II of the EPA 1990[959] and the Waste Management Licensing Regulations 1994,[960] and the Groundwater Regulations 2009.[961] The Regulations require an 'operator'[962] of a 'regulated facility'[963] to obtain an 'environmental permit'[964] from the 'regulator'.[965] According to regulation 7:

[955] EPA 1990, s 78F(2).
[956] Environmental Permitting (England & Wales) Regulations (EPR) 2010, SI 2010/675.
[957] Department for Environment, Food and Rural Affairs, *Environmental Permitting Guidance: Core Guidance – For the Environmental Permitting (England and Wales) Regulations 2010* (Defra, March 2013), para 1.1.
[958] Pollution Prevention and Control (England and Wales) Regulations 2000, SI 2000/1973 (as amended).
[959] EPA 1990, pt II.
[960] Waste Management Licensing Regulations 1994, SI 1994/1056.
[961] Groundwater (England and Wales) Regulations 2009, SI 2009/2902.
[962] EPR 2010, reg 7.
[963] ibid, reg
[964] ibid, regs 13-14.
[965] ibid, regs 32-33.

> '… "an operator", in relation to a regulated facility, means— (a) the person who has control over the operation of the regulated facility, (b) if the regulated facility has not yet been put into operation, the person who will have control over the regulated facility when it is put into operation, or (c) if a regulated facility authorised by an environmental permit ceases to be in operation, the person who holds the environmental permit.'

There are nine classes of regulated facility requiring an 'environmental permit' under the Regulations,[966] such as: an installation,[967] a mobile plant,[968] a waste operation,[969] a water discharge activity,[970] and a groundwater activity.[971] The regulator has a duty to periodically review environmental permits and inspect regulated facilities.[972] A 'risk-based approach to compliance assessment' should be taken.[973] It is the operator's responsibility to ensure that the regulated facility does not cause pollution of the environment and harm to human health.[974] If the regulator believes that 'an operator has contravened, is contravening, or is likely to contravene an environmental permit condition' it may serve an enforcement notice[975] or suspension notice[976] on the operator of the facility. There are a number of offences under the Regulations.[977] For example, a person that operates a regulated facility without an environmental permit,[978] or fails to comply with an environment permit condition commits an offence under regulation

[966] Defra 2013 (n 944), para 3.5.
[967] EPR 2010, reg 8(1)(a). See also, EPR 2010, sch 1.
[968] ibid, reg 8(1)(b).
[969] ibid, reg 8(1)(c).
[970] ibid, reg 8(1)(f).
[971] ibid, reg 8(1)(g).
[972] ibid, reg 34(2).
[973] Defra 2013 (n 944), para 11.2.
[974] ibid, para 11.3.
[975] EPR 2010, reg 36.
[976] ibid, reg 37.
[977] ibid, reg 38.
[978] ibid, reg 38(1).

38.[979] A person guilty of an offence under regulation 38 is liable to a penalty.[980] The Regulations say that a person otherwise guilty of an offence has a defence if they committed the contravention in an emergency, and only did so in order to avoid danger or harm to human health.[981] Where the regulator considers there to be a risk of 'serious pollution', it has the power to take the necessary steps for the pollution to be prevented or remedied.[982] The costs can be recovered from the operator of the facility.[983]

Considering the heightened demand to 'permit' operations through a system of environmental licensing, and the consequences of acting contrary to such a system, it is important that the Environmental Permitting Regulations 2010 are included within this analysis. It is very unlikely that a lender would incur direct liability as an 'operator' of a regulated facility. However, regulation 7(a) states that an operator is the person that has 'control' over the operation of the regulated activity.[984] If a lender has a significant degree of participation in the management of its borrower's business activities, there is a chance that it may be held to have the sufficient control that is necessary to be classed as an operator. As with the laws outlined above, the indirect and reputational risks are much more of an issue when lending to a customer of a permitted operation. While environmental licensing systems are necessary to prevent and remedy any environmental harm that may be caused by regulated operations, the need to comply with the conditions of a permit has put increased pressure on some business sectors. Liability for committing an offence under the Regulations can result in penalties for an operator, which can force a business to enter insolvency proceedings.

[979] ibid, reg 38(2).
[980] ibid, reg 39.
[981] ibid, reg 40(1).
[982] ibid, reg 57(1).
[983] ibid, reg 57(4).
[984] ibid, reg 7(a).

A borrower in insolvency heightens the probability of credit risk for its lender. This also leads to the question of, what happens to the environmental licence if an operator becomes insolvent? While this is dealt with in detail in Chapter 4, the licence may remain attached to the land as 'onerous property'.[985] The value of land that has an onerous licence attached to it may depreciate, resulting in a security risk for creditors. Thus, the Environmental Permitting Regulations 2010 have heightened the likelihood of credit and security risks (not lender liability) for banks.

C. Part II of the EPA 1990

Part II of the EPA has now been largely replaced by the Environmental Permitting (England and Wales) Regulations 2010. Nevertheless, Part II is still the main legislative source covering offences relating to unlawful deposits etc. of controlled waste.[986] This section shall look at the risks posed to lenders by the criminal, civil and clean-up liability under Part II.

Criminal offences for waste fall under section 33 of the EPA 1990. There are three primary ways in which liability may materialise under section 33(1), including:

- 'Deposit controlled waste or extractive waste, or knowingly cause or knowingly permit controlled waste or extractive waste to be deposited in or on any land unless an environmental permit authorising the deposit is in force and the

[985] infra, ch 4, pp 208-219.
[986] For a good overview of Part II of the EPA 1990 see Lawrence and Lee, 'Talking 'bout my generation' (n 35) 97-106.

deposit is in accordance with the licence;

- Submit controlled waste, or knowingly cause or knowingly permit controlled waste to be submitted, to any listed operation (other than an operation within subsection (1)(a)) that— (i) is carried out in or on any land, or by means of any mobile plant, and (ii) is not carried out under and in accordance with an environmental permit; and

- Treat, keep or dispose of controlled waste or extractive waste in a manner likely to cause pollution of the environment or harm to human health.'[987]

Any person that contravenes section 33(1) shall commit an offence.[988] Liability on summary conviction for an offence under this section may lead to a term of imprisonment not exceeding twelve months,[989] or a fine not exceeding £50,000.[990] On conviction on indictment, the person that committed the offence may serve a term of imprisonment not exceeding five years, a fine, or both.[991] Section 33(9) states that, 'a person (other than the establishment or undertaking)',[992] may also incur liability. If such a person is found guilty on indictable conviction, the court may award a fine.[993] A person liable to an offence under section 33(1) (or section 63 (2) of the EPA 1990 for 'waste other than controlled waste') can be forced to compensate the victim for their loss by way of an award of damages.[994] It shall be a defence to show that the offence

[987] EPA 1990, s 33(1).
[988] ibid, s 33(6).
[989] ibid, s 33(7)(a).
[990] ibid, s 33(7)(b).
[991] ibid, s 33(8)(b).
[992] ibid, s 33(9).
[993] ibid, s 33(9)(b).
[994] ibid, s 73(6).

was committed under the exercise of reasonable due diligence, or that the unlawful deposit was done in the interests of safety.[995] An unlawful deposit of waste may also generate civil liability, as a consequence of a breach of statutory duty, for responsible parties.[996] Section 33B allows the enforcement of clean-up costs where an offence has been committed under section 33(1) of the EPA, or regulations 38(1) and 38(12) of the Environmental Permitting Regulations 2010 (as amended). Criminal liability under section 33(1)(a) of the EPA 1990 does not apply to any of the operations listed in Schedule 25 to the Environmental Permitting Regulations 2010.[997] If a person's land causes pollution without the occupier being at fault, the person to which liability is allocated may be able to claim back the money from the person that originally deposited the waste under section 130(1)(a) of the Powers of Criminal Courts (Sentencing) Act 2000.[998] This section limits payment to £5,000.[999] Also, 'any person who imports, produces, carries, keeps, treats or disposes of controlled waste', has a duty of care in respect to that waste.[1000] Under section 34 of the EPA, the waste producer is under a statutory duty of care to assign the waste to a registered waste carrier, who must also exercise their section 34 obligation. Breaching section 34 could lead to an unlimited fine in the Crown Court.[1001] With regards to criminal liability under section 33, asset recovery must also be considered, as it is now widely used in waste cases. According to the Proceeds of Crime Act (POCA) 2002, which established the Asset Recovery Agency,[1002] any financial benefit obtained by criminal conduct can be recovered from convicted defendants by the court's service of a confiscation order.[1003] If this happens

[995] ibid, s 33 (7)(a)-(c).
[996] ibid, s 73(6).
[997] EPR 2010, reg 68(2).
[998] EPA 1990, s 33B(2).
[999] ibid, s 33B(5).
[1000] ibid, s 34(1).
[1001] ibid, s 34(6).
[1002] Proceeds of Crime Act 2002, pt I.
[1003] EPA 1990, pt II.

to a borrower, this will ultimately heighten the likelihood of the bank suffering credit risk on the loan. There is also the possibility of harmful reputational damage from being associated with a client that is convicted of criminal conduct.

Under section 59(1), if controlled waste has been deposited in contravention to section 33(1) [or Regulation 12 of the Environmental Permitting Regulations], the Environment Agency or waste collection authority may require the occupier, by notice, to remove the waste or to take steps to eliminate or reduce the deposit's consequences.[1004] Also, section 59ZA of the EPA 1990 states that the waste regulation, or waste collection authority, may require the owner of land to comply with the requirements outlined in section 59 of the EPA. The authority will issue a notice onto the owner where a deposit of waste is made in contravention to section 33 [or Regulation 12] and there is no occupier of the land or the authority would incur an unreasonable expense in order for the occupier to be found.[1005] A person issued with a notice to remove the waste must do so within a period of twenty-one days from when the notice was first served.[1006] The notice may be appealed to the magistrates' court also within this period.[1007] And the magistrates may quash the authority's decision.[1008] By virtue of section 59(7), the waste regulation or collection authority reserves the right to remove, or eliminated the threat of, the waste deposited in or on the land.[1009] The authority shall be entitled to recover any costs incurred by the works from either the occupier, or any person that deposited or knowingly caused or knowingly permitted the deposit upon the land.[1010] If the occupier proves that, 'he neither made nor knowingly

[1004] ibid, s 59(1)(a)-(b).
[1005] ibid, s 59ZA.
[1006] ibid, s 59(1)(a).
[1007] ibid, s 59(2).
[1008] ibid, s 59(3)(a)-(b).
[1009] ibid, s 59(7)(a)-(c).
[1010] ibid, s 59(8)(a)-(b).

caused nor knowingly permitted the deposit of waste', the recovery of costs by the authority is not justified under the EPA 1990.[1011] When waste is removed by an authority, 'it shall belong to that authority'.[1012] This means that the occupier's duty of care to that waste under section 34 of the EPA is extinguished by the act of removal.

Following the discussion above, lender liability is capable of materialising under Part II of the EPA. Part II of the EPA has been largely replaced by a number of legislative sources e.g. the Environmental Permitting Regulations 2010. Before Part IIA of the EPA was brought into force in 2000 and 2001, Part II was the primary legislative source for contaminated land clean-up. Today Part II and Part IIA share a working relationship. Part IIA deals solely with historic contaminated land; on the other hand Part II covers recent unlawful deposits of waste. Thus, the two regimes complement each other. While lender liability for an unlawful deposit of waste (etc.) is unlikely, liability may attach to a mortgagee in possession of land. This happened in *Devon Waste Regulation Authority v Midland Bank plc (Unreported) (Mag Ct)* (1995) 8(9) *Insolv Int.* 75 ('the Midland Bank case'), where Midland Bank was charged under Part II of the EPA 1990 (which was the statutory provision that was used before the enactment of Part IIA) for the remediation of contaminated tyres that were found on the site by the local authority. Lender liability, as witnessed in the case of *Midland Bank*, is quite severe should it materialise. However, today, it is an unlikely outcome, as the environmental risk management frameworks in banks would not allow foreclosure unless there is good evidence to show that the land is profitable.[1013] If waste is found on land, and the land

[1011] ibid, s 59(8)(a).
[1012] ibid, s 59(9).
[1013] infra chs 6 and 7.

is determined an unprofitable investment, the bank would simply walk away from the property, rendering it *terra nulla*.[1014]

Increased regulatory pressures for waste management are beginning to affect the economic efficacy of business operations; and this is especially so for small to medium sized enterprises (SMEs) working within the waste industry.[1015] In relation to this issue, Egede and Lee stress that:

> 'The scrap metal industry was brought clearly within the realm of waste regulation for the first time in 1994, and the impact on that sector is still being felt as slowly the regulatory noose tightens.' [1016]

For banks, 'the tightening of the regulatory noose' has heightened their likelihood of sustaining credit and security risks because of their borrowers' non-compliance with the law.[1017] One respondent, who works for one of the UK's major, clearing banks, stated that:

> *R_1: We have had a lot of problems with waste transfer stations, when they go bust, because, when they go bust, for the previous 6 months, they open their doors and everyone comes in and dumps their waste in, and they shut the doors. You can't sell that site without removing the waste. So that*

[1014] ibid.
[1015] Lawrence and Lee, 'Talking 'bout my Generation' (n 35) 93.
[1016] Egede and Lee (n 56) 869-870.
[1017] ibid.

> *has an impact both on value and saleability, as well as because you wouldn't want to be taking possession of that sort of property.* [1018]

Also, the waste hierarchy encourages agents within the waste cycle to adopt more sustainable forms of waste management before depositing waste at landfill.[1019] This was done in order to develop sustainable methods of waste recovery by making unsustainable processes (like landfilling) increasingly more difficult to use.[1020] Landfill Directive 1999/31/EC[1021] and Council Decision 2003/33/EC[1022] aim to encourage the use of more sustainable forms of waste management by banning certain substances from landfill. The Directive encourages the categorisation of waste (see Waste Assessment Criteria (WAC))[1023] and prevents the co-disposal of non-hazardous[1024] and hazardous waste[1025] at the same site.[1026] Furthermore, in 2012, all section 43B certificates, which allowed contaminated material exemption from landfill tax, were revoked.[1027] This now means that developers will make less profit from their contaminated sites, increasing the likelihood of lenders suffering credit risk on their loans. If waste from contaminated sites is deemed as 'hazardous' under Annexes I, II,

[1018] Interview with Respondent 1.
[1019] See, Department for Environment, Food and Rural Affairs, *Guidance on applying the waste hierarchy* (Defra, June 2011) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69403/pb13530-waste-hierarchy-guidance.pdf> accessed 18 September 2014.
[1020] ibid, para 1.1.
[1021] Council Directive 1999/31/EC of 26 April 1999 on the landfill of waste OJ L 182, 16/07/1999 P. 0001 – 0019.
[1022] Council Decision of 19 December 2002 establishing criteria and procedures for the acceptance of waste at landfills pursuant to Article 16 of and Annex II to Directive 1999/31/EC.
[1023] Environment Agency, *Waste acceptance at landfills: Guidance on waste acceptance procedures and criteria* (EA November 2010) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/296422/geho1110btew-e-e.pdf> accessed 18 September 2014.
[1024] ibid, paras 5.1 – 5.2.
[1025] ibid, paras 6.1 – 6.5.
[1026] ibid.
[1027] Finance Act 1996, pt III.

or III of the Hazardous Waste (England and Wales) Regulations 2005,[1028] the consignee must send the waste to a landfill site that is registered to deal with hazardous substances.[1029] This will come at a further expense[1030] to developers, due to the need to transport the waste to the appropriate operating facility. In Wales, for example, there are no 'commercial hazardous waste landfill sites',[1031] so any substance that is recovered from a redevelopment project, and is classed as hazardous, needs to be sent to England for disposal. Although this thesis is concerned primarily with the English legal system, the reference to the lack of hazardous waste sites in Wales nevertheless strengthens the argument that increased regulatory activity during an economic depression has not had a favourable effect on reducing the mortgagees' indirect risks from projects concerning land redevelopment. It is quite clear that waste regulation has made loan financing to borrowers that operate in the waste sector a much riskier and less profitable enterprise.

D. Part III of the EPA 1990

Part III of the EPA 1990[1032] provides a regulatory regime for nuisance in the UK. While the codification of this area has impacted upon the use of common law nuisance, it is now quicker and easier to apply nuisance in practice. However, in *Barr & Ors v Biffa*

[1028] Hazardous Waste (England & Wales) Regulations 2005, SI 2005/894 (as amended by Hazardous Waste (England & Wales) (Amendment) Regulations 2009, SI 2009/507).
[1029] ibid, anns I, II, and III.
[1030] According to one report the median costs of hazardous waste gate fees in 2013 ranged from £35 - £56, depending upon the hazardous waste code of the substance(s) being deposited. Please see, WRAP, 'Comparing the costs of alternative waste treatment options: Gate fees report 2013' (*WRAP*, no date) <http://www.wrap.org.uk/sites/files/wrap/Gate_Fees_Report_2013_h%20(2).pdf> accessed 2 June 2014. The gate fees, which are rather more costly for hazardous waste than other forms of waste, can be increased further when one considers removal and transportation costs.
[1031] Environment Agency, 'Hazardous Waste in Wales' (EA no date) <http://www.environment-agency.gov.uk/research/library/data/98052.aspx> accessed 23 July 2012.
[1032] EPA 1990, pt III.

Waste Services Ltd [2012] EWCA Civ 312 Carnwarth LJ specified that, 'I continue to believe that the applicable law of nuisance is relatively straightforward, and that the 19th century principles for the most part remain valid.'[1033]

Section 79(1) of the EPA lists activities that can give rise to a statutory nuisance.[1034] It includes such things as, 'any premises in such a state as to be prejudicial to health or a nuisance',[1035] 'smoke emitted from premises so as to be prejudicial to health or a nuisance',[1036] and, 'any accumulation or deposit which is prejudicial to health or a nuisance'.[1037] Pursuant to Part III, every local authority is under a duty to inspect its area from time to time for any statutory nuisances.[1038] Where a person living in the authority's area makes a complaint of statutory nuisance, the authority must 'take such steps as are reasonably practicable to investigate the complaint.'[1039] If a nuisance exists, or is likely to occur or recur, the local authority will serve an abatement notice onto any responsible parties.[1040] This notice may require the interference's prohibition,[1041] and could also outline works that are necessary to inhibit the activity's further unreasonable affect.[1042] At first instance, the local authority will attempt to identify the person responsible for causing the nuisance.[1043] If the persons responsible for the nuisance cannot be found, the abatement notice is to be served onto the current owner or occupier

[1033] *Barr & Ors v Biffa Waste Services Ltd* [2012] EWCA Civ 312, para 44 (Carnwarth LJ). cf M Stallworthy, 'Environmental liability and the impact of statutory authority' (2003) *J Env L* 3. See also the recent case of *Coventry and others (Respondents) v Lawrence and another (Appellants)* [2014] UKSC 46 supports this argument.
[1034] EPA 1990, s 79(1).
[1035] ibid, s 79(1)(a).
[1036] ibid, s 79(1)(b).
[1037] ibid, s 79(1)(d).
[1038] ibid, s 79(1).
[1039] ibid.
[1040] ibid, s 80(1).
[1041] ibid, s 80(1)(a).
[1042] ibid, s 80(1)(b).
[1043] ibid, s 80(2)(a).

of the land.[1044] A person that is served with a notice may appeal the decision within a period of twenty-one days from the date upon which it is first served.[1045] Failure to comply with the statutory notice is a criminal offence,[1046] which may result in a fixed penalty notice.[1047] It will be a defence to show that the best practical means were used to prevent the creation of the nuisance,[1048] or that the defendant has a reasonable excuse for the non-compliance.[1049] Expenses can be recovered from the owner by a charge on the land,[1050] with the possibility of paying by instalments.[1051] Any persons aggrieved by a statutory nuisance may, by way of summary application to the magistrates' court, request that an order be made for the nuisance's abatement,[1052] or to prevent its recurrence.[1053] If the magistrates are satisfied that a nuisance exists, or is likely to exist if an activity is not abated, an order will be granted under section 82 at the instance of the applicant.[1054] Section 82 also states that, where the person responsible for the nuisance cannot be found, proceedings shall be brought against the current owner of the premises.[1055]

A number of risks can emerge for a bank because of an abatement notice under Part III. Direct liability may be incurred if the bank is identified as the person responsible for causing a statutory nuisance by the local authority. However, unless the bank has a significant amount of control or participation in the activity that creates the nuisance,

[1044] ibid, s 80(2)(c).
[1045] ibid, s 80(3).
[1046] ibid, s 80(4).
[1047] ibid, ss 80(4A) and 80(ZA).
[1048] ibid, s 80(7).
[1049] See, *Lambert Flat Management Ltd v Lomas* [1981] 1 WLR 898, DC.
[1050] EPA 1990, s 81A.
[1051] ibid, s 81B.
[1052] ibid, s 82(2)(a).
[1053] ibid, s 82(2)(b).
[1054] ibid.
[1055] ibid, s 82(4)(b).

this risk is unlikely to materialise. Nevertheless, as sections 80, 81A, and 82 show, where the person responsible for the nuisance cannot be found, proceedings may be brought against the owner of the facility. Thus, a mortgagee in possession of property causing a nuisance may incur lender liability under Part III. While the risk of lender liability for statutory nuisance is low, the indirect and reputational risks should be seen as much more of a threat. With regards to credit and security risks, an abatement notice could confine the operational hours of a business, creating credit risk. As mentioned earlier, the court in *Coventry v Lawrence* (2012)[1056] ordered an injunction to limit the operational hours of a motorsports stadium. Also, any bank that is associated with a client or property that is causing a nuisance may be at risk of reputational harm.

E. Water Resources Act 1991

Section 161 of the Water Resources Act 1991 confers upon the EA a statutory power that enables it to undertake any anti-pollution works and operations that it deems necessary. The EA may recover any expenses reasonably incurred from the person(s) who either caused or knowingly permitted the polluting matter to enter or be present in any controlled waters.[1057] Correspondingly, the EA could also require other persons to carry out anti-pollution works by issuing a section 161A works notice.[1058] The notice can be appealed within twenty-one days from service to the Secretary of State,[1059] and the non-compliance with a notification constitutes an offence.[1060]

[1056] *Coventry* (n 782).
[1057] Water Resources Act 1991, s 161(3)(a)-(b).
[1058] ibid, s 161A.
[1059] ibid, s 161C.
[1060] ibid, s 161D.

Thus, a section 161A works notice may be served on a mortgagee in possession, resulting in lender liability. Alternatively, if a mortgagor is forced to pay for the anti-pollution works, credit risk could be incurred by the mortgagee.

F. Wildlife and Countryside Act 1981

Conservation law can restrict the use of an area that is regarded as a 'special interest' because of its flora, fauna, geology, etc. There are many laws which regulate and protect habitats or specified species e.g. the Habitats Directive 1992/43/EEC[1061] and the Wild Birds Directive 1979.[1062] However, one of the most notable national laws for conserving the natural environment can be seen in the Wildlife and Countryside Act (WCA) 1981.[1063] The 1981 Act has created risks for lenders that own or occupy, or have borrowers that own or occupy, land. It is, therefore, necessary to mention the WCA in this section of the chapter. So, how may the WCA 1981 restrict the use of land, creating risks for lenders? First, owners and occupiers of land that is a 'habitat' may face direct liability if they breach specific statutory duties by conducting regulated operations without the required consent. For example, section 28 of the WCA establishes 'sites of special scientific interests' (SSSIs), which are sites that Natural England considers to be, 'a special interest by reason of any of its flora, fauna, or geological or physiographical features.'[1064] When designating an SSSI, Natural England is under a duty to notify, *inter alia*, 'every owner or occupier to any of that

[1061] Council Directive 1992/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora OJ L 206 , 22/07/1992 P. 0007 – 0050.
[1062] Directive 2009/147/EC of the European Parliament and of the Council of 30 November 2009 on the conservation of wild birds OJ L 20, 26.01.2010, 7–25.
[1063] Wildlife and Countryside Act (WCA) 1981.
[1064] WCA 1981, s 28.

land of the designation.'[1065] The duties of owners and occupiers in relation to SSSIs are set out in the section 28E of the WCA.[1066] It states that, 'the owner or occupier of any land included in a site of special scientific interest shall not, while the notification under section 28(1)(b) remains in force, carry out, or cause or permit to be carried out, on that land, any operation specified in the notification.'[1067] Liability under this section is subject to specific exceptions,[1068] and the conditions may be withdrawn or modified by Natural England.[1069] If a person breaches section 28(1) of the WCA, they commit an offence.[1070] A person guilty of such an offence may be liable to a fine not exceeding £20,000 on summary conviction, or a fine on indictable conviction.[1071] On the one hand, this restriction may impact the value of land, causing security risk for the bank that secures the property under the mortgage. On the other hand, if a borrower commits an offence under the WCA 1981, prospects of the repayment of the loan may be lost, resulting in a credit risk. While less likely, if a bank forecloses upon the property, becoming a mortgagee in possession, it may incur any fines as an owner or occupier under section 28 of the WCA.

Although the designation of land as a habitat is capable of creating risks for the bank, invasive ecological species have also proven significantly problematic. It has been calculated that the annual cost to deal with Japanese knotweed in Britain was £165 million in 2013-2014.[1072] Knotweed reduces land value, and is difficult to remediate.

[1065] ibid.
[1066] ibid, s 28E.
[1067] ibid, s 28E.
[1068] ibid, s 28E(1)(a)-(b).
[1069] ibid, s 28E(6)(a)-(b).
[1070] ibid, s 28P(1).
[1071] ibid.
[1072] House of Commons Environmental Audit Committee, *Invasive non-native species: Fourteenth Report of Session 2013-2014* (HC 913, 16 April 2014) 11 <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmenvaud/913/913.pdf> accessed 18 September 2014.

Lenders are aware of the risks that can materialise where Japanese knotweed is present on land. For example, Respondent 2 said in interview:

> *R_2: Yeah, it's like a big weed and they grow up to eight feet tall and they're really hard to remove, uhm, I mean one way is to try and burn it, and then you're stuck with the roots and then they go up. They're so hardy that they start to break into foundations and they are a real problem on sites. I mean bio-diversity is a big thing in development sites, because they need it to determine the archaeology, and it may stop development, and that can cause delays.*[1073]

Japanese knotweed's hardy rhizome means that it is a difficult plant to kill. Knotweed is capable of causing damage to property, and, as a consequence, will depreciate the value of any land that it is situated upon. While it is not illegal for knotweed to be situated on a piece of land, it is an invasive species, and, under section 14(2) of the WCA 1981, a person will commit a criminal offence if, 'they plant or otherwise cause [Japanese knotweed] to grow in the wild.'[1074]A person guilty of an offence shall, on summary conviction, be liable to a maximum period of six months imprisonment, or a £40,000 fine, or both.[1075] Upon indictable conviction the prison sentence may increase to two years, or an unlimited fine may be awarded, or both.[1076] Failure to lawfully dispose of Japanese knotweed could lead to liability under Part II of the EPA 1990, as the plant is a 'controlled waste'.[1077] By being a controlled waste Japanese knotweed

[1073] Interview with Respondent 2.
[1074] WCA 1981, s 14(2).
[1075] ibid.
[1076] ibid.
[1077] EPA 1990, s 34.

must be disposed of in accordance with the appropriate waste legislation. A failure to do so could amount as a contravention of sections 33 and 34 of the EPA (see section on waste). Its excavation requires compliance with the permitting system and must be sent to a licensed site and buried at a depth of five metres. Persons within the waste transfer chain must apply the waste hierarchy and have a duty to comply with the Environmental Permitting (Duty of Care) Regulations 1991.[1078]

Banks are not likely to be fixed with direct liability for Japanese knotweed under the WCA 1981 or section 34 of the EPA 1990. Nevertheless, there are the indirect and reputational risks to consider. The Royal Institute of Chartered Surveyors' (RICS) information pamphlet on, *Japanese Knotweed and Residential Property* (2012)[1079] stated that, 'In the last few years this uneasy relationship with the plant became more than a problem when some lenders reviewed their policies. A number of loans on properties were declined.'[1080] The Council of Mortgage Lenders (CML) and Building Societies' Association (BSA) have shown that there is a general reluctance throughout the lending community to grant mortgages to properties subject to Japanese knotweed.[1081] And this reluctance has emerged because of the credit and security risks that attach to land where Japanese knotweed is present.

[1078] Environmental Permitting (Duty of Care) Regulations 1991.
[1079] Royal Institute of Chartered Surveyors, 'Japanese Knotweed and Residential Property' (RICS, 2012) <http://www.rics.org/uk/knowledge/professional-guidance/information-papers/japanese-knotweed-and-residential-property-1st-edition/> accessed 7 October 2014.
[1080] ibid 3
[1081] ibid. See also, R Gray, 'Mortgages refused over invasive weed' *Daily Telegraph* (London, 13 March 2010) <http://www.telegraph.co.uk/property/propertynews/7436431/Mortgages-refused-over-invasive-weed.html> accessed 15 September 2014.

III. Emerging Risks

The sources of law discussed in this chapter regulate pollution, or activities which can lead to pollution, on land. The data show that lenders have become used to mitigating land pollution risks during their conduct of pre- and post-loan due diligence.[1082] This section assesses, what may be termed as, 'the emerging legal liabilities' for lenders operating in the UK, i.e. climate change and flooding. While issues relating to climate change and flooding have been around for quite some time, the interview data suggest that these two risks are overtaking land pollution as the main legislative threat for financial institutions.

A. Climate Change

Despite being a difficult issue to address, legal controls have been developed at international, European, and national levels in order to tackle climate change. In the UK, for example, section 1 of the Climate Change Act 2008[1083] establishes a duty for the Secretary of State to ensure that the net UK carbon account for the year 2050 is lower than the 1990 baseline.[1084] Banks, like everyone else, are concerned about the future implications that climate change will have. From the data, it is apparent that lenders are beginning to question how the banking structure, and financial transactions, will respond to the long-term risk exposure caused by the changing climate. When asked about future environmental risks for lenders, one respondent stated that:

[1082] Refer to chs 7 and 8.
[1083] Climate Change Act 2008.
[1084] ibid, s 1(1)-(2).

R_{11}: And the other one that we have not touched on is climate change. How do financial institutions get a handle on the longer-term risk exposure? At the moment, it is challenging understanding how the nuances of environmental regulation will change; but change they will. You've just got to accept that there is a relatively material level of change there. The challenge is that we know that there is more demand for disclosure from investors and from civil society; from banks' responses to climate change… and a lot of those are taking the short-term – "Do you finance carbon intensive projects?" – starts right now… But actually there will be a point in time where the question is: What is the aggregate carbon exposure, or climate change exposure, of all of your loan portfolio, which goes back to the point I made earlier around reporting scopes and understanding financed emissions; but it has to be done in a lot more sophisticated manner; and it is not just about emissions – which is a crude way of capturing the exposure – but around how a client prepares for the potential impacts of climate change. I think it is an in issue that society is trying to deal with at the moment, and there are a lot of interesting cognitive studies into actually why we are taking so long to come up with the mechanism to address this. It is the next frontier! Not just how you respond, internally, within your organisation; but how do you engage with clients and discuss. There we are where we were with environmental risk management twenty years ago.[1085]

[1085] Interview with Respondent 11.

Climate change, like land pollution twenty-five years ago, is a growing threat to commercial loan financing; and this is particularly so for industries that have a high aggregate carbon exposure. The threat of climate change raises a number of pertinent questions in relation to the future of environmental risk management practices in banks. For example, will lenders be forced, in the near future, to measure the climate change exposure of their individual loan portfolios? How will the relationship between lenders and their clients operating in high risk areas change (if at all)? Will banks be made accountable for their borrowers' polluting operations? How will environmental due diligence change? Is it possible for climate change to affect land value?

There are a number of legislative initiatives that regulate activities which may increase the rate of climate change. Industrial sectors that are likely to harm the environment have been placed under increased pressure to comply. For example, the climate change levy, which was brought into force by Part II of the Finance Act 2000[1086] (as amended),[1087] taxes 'polluting commodities',[1088] i.e. electricity, natural gas, liquid petroleum gas, and coal, lignite and coke.[1089] Also, the EU Emissions Trading System (ETS) has now begun its third phase of operation (2013 – 2020), and currently regulates the air emission of more than 11,000 power stations and industrial plants in more than thirty-one countries.[1090] Europe's 'cap and trade' system was introduced by Directive 2004/101/EC,[1091] and imposed into the UK by the Greenhouse Gas Emissions Trading

[1086] Finance Act 2000, pt II.
[1087] Finance Act 2006.
[1088] Finance Act 2000, pt V.
[1089] ibid.
[1090] European Commission, 'The Emissions Trading System (EU ETS)' (*European Commission*, 4 January 2013) <http://ec.europa.eu/clima/policies/ets/index_en.htm> accessed 12 June 2013.
[1091] Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004 amending Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms OJ L 338, 13.11.2004, 18–23.

Scheme Regulations 2012.[1092] The cap and trade system operates by capping emissions levels through the appointment of allowances per each individual installation.[1093] Emissions now have a value; and surplus allowances are a commodity that may be purchased by installations that exceed their annual emissions cap.[1094] Essentially the ETS is a green method for reducing carbon emissions through economic competition.[1095] While the ETS is a good idea in theory, the low carbon price has meant that it has little effect in practice.

As well as heavy industry, SMEs and homeowners are also being affected by the introduction of climate change legislation. The 'Green Deal',[1096] for instance, is a government initiative to encourage the reduction of carbon emission through energy efficiency.[1097] However, "Green Deal loans"[1098] may be detrimental for the financial community. The CML's website portrays that such a loan remains as, 'a charge on the property for which future owners become responsible.'[1099] The article also suggests that if a lender goes into possession of a property, 'it may be liable for continuing payments.'[1100] The CML states that having such a charge over the land will ultimately make selling the property more difficult, reducing its value and marketability.

[1092] ibid.
[1093] Greenhouse Gas Emissions Trading Scheme Regulations 2012, SI 2012/3038 (as amended).
[1094] European Commission (n 1090).
[1095] ibid.
[1096] Energy Act 2011, pt 1.
[1097] Green Deal Initiative, 'What is the Green Deal?' (*Green Deal Initiative website*, no date) <http://www.greendealinitiative.co.uk/> accessed 17 August 2012.
[1098] 'The Green Deal Explained' (*Which?* no date) <http://www.which.co.uk/energy/creating-an-energy-saving-home/guides/the-green-deal-explained/what-is-the-green-deal/> accessed 19 September 2014. The websites states that, 'Green Deal loans are repaid through your electricity bill. The way the deal differs from a standard loan is that the repayments you'll make on the loan will (in theory at least) be covered by the energy bill savings you make from having the energy-saving home improvements installed. This system is known as the 'Golden Rule' - you should not pay back more in loan repayments than you are saving on your energy bill.'
[1099] Council of Mortgage Lenders, 'Lenders respond to Green Deal proposals' (*CML*, 1-17 January 2012) <http://www.cml.org.uk/cml/publications/newsandviews/105/391#> accessed 12 June 2013.
[1100] ibid.

Nevertheless, the Green Deal has not had a significant impact, and has been described as a 'failure'.[1101]

Lender liability is not really an issue under climate change legislation. Nevertheless, the different initiatives listed above show a general theme; that legislative compliance is placing all types of borrowers under pressure, and this is increasing indirect and reputational risks for the bank lending community. And this must be taken into account by banks, because it is likely that their exercise of due diligence is going to change in order to consider their clients' roles in global warming. In the future, it will not be enough to simply ask "Is this site contaminated?" and "What will it take to remediate it?" Indeed, environmental due diligence may develop to such an extent that it will be necessary for banks to calculate the aggregate carbon exposure of individual loan portfolios.

B. Flooding

The second 'emerging environmental risk' for banks, according to the data, is flood risk.

R_2: Well I don't know if you've taken flooding into consideration?

I: Yes, I've done a bit on that.

[1101] E Gosden, 'Green Deal energy efficiency scheme a "disappointing failure"' *Daily Telegraph* (London, 15 September 2014) <http://www.telegraph.co.uk/earth/energy/11095359/Green-Deal-energy-efficiency-scheme-a-disappointing-failure.html> accessed 19 September 2014.

> *R_1: So, if a property gets flooded then it loses its value and they [the borrower] become unable to pay the loan back. So that's assessment – desktop study – assessment! And, obviously, the insurance is getting higher and higher on that, so that's going to impact people.*[1102]

The two main types of flooding are pluvial inundation (damage caused by heavy rainfall) or fluvial inundation (damage caused by rivers or seas).[1103] Flooding has increased over the last few years, and the EA has suggested that over 5.5 million (or one in six properties) are currently at risk across England and Wales.[1104] Notwithstanding the fact that much has been done since Sir Michael Pitt's review of flood management in 2007,[1105] the natural occurrence of water inundation has proven difficult to control, as witnessed by the series of floods that have occurred repeatedly over the last few years. Consequently, the National Planning Policy Framework[1106] suggests that, 'inappropriate development in areas at risk of flooding should be avoided by directing development away.'[1107] This is not a good prospect for the local economies of the high-risk zones, or for businesses that are already situated within such zones. Respondent 13, who works for a bank in Switzerland, believes that, along with climate change, flooding could become a serious threat to both land value and businesses in the UK.

[1102] Interview with Respondent 2.
[1103] AS Chen, S Djordjević, J Leandro and DA Savić, 'An analysis of the combined consequences of pluvial and fluvial flooding' (2010) 62(7) *Water Sci Technol* 1491.
[1104] Environment Agency, 'How to Manage Flood Risks' (EA no date) <http://www.environment-agency.gov.uk/homeandleisure/floods/31666.aspx> accessed 12 June 2013.
[1105] M Pitt 'Learning lessons from the 2007 floods: an independent review by Sir Michael Pitt' (The Cabinet Office 2008) <http://webarchive.nationalarchives.gov.uk/20100807034701/http://archive.cabinetoffice.gov.uk/pittreview/_/media/assets/www.cabinetoffice.gov.uk/flooding_review/pitt_review_full%20pdf.pdf> accessed 12 June 2013
[1106] NPPF (n 4).
[1107] ibid, para 100.

> *R_{13}: Well in the UK it could be in flood areas [talking about emerging environmental risks].*[1108]

On 23 May 2013 the Law Society issued a Practice Note on flood risk for solicitors involved in property transactions.[1109] The Practice Note states:

> 'Flooding is a growing risk for British property. Aside from physical damage caused by floods, if a property is at risk of flooding it may be difficult to:
>
> - obtain a mortgage
> - obtain suitable insurance cover, or
> - sell the property.
>
> This is likely to affect the value of the property.'[1110]

In relation to the advice that a solicitor should give when acting for a lender in conveyancing transactions, the Law Society recommends:

> 'You may have additional obligations when acting for lenders. Lenders are increasingly likely to investigate the potential flood risk of prospective security either as part of their valuation process or by searching. Lenders

[1108] Interview with Respondent 13.
[1109] The Law Society, *Flood Risk* (*The Law Society*, 23 May 2014) <http://www.lawsociety.org.uk/advice/practice-notes/flood-risk/> (accessed 28 November 2013).
[1110] ibid, para. 1.2.

> may impose additional requirements in their instructions to you as a result of their investigations.'[1111]

Rather than being fearful of being made liable under a specific law, the Practice Note implies that banks are becoming more concerned about the indirect risks that may emerge from flooding. And indeed lenders should be concerned. The Association of British Insurers' (ABI) website states that, 'The wettest winter on record [2013] is likely to result in £446 million being paid in insurance claims to customers whose homes, businesses, and vehicles were flooded – the equivalent of £6.7 million a day - according to updated figures.'[1112] Insurance companies have become increasingly reluctant to grant cover to properties within high risk flood areas. This is problematic for borrowers, since, 'Mortgage providers and other lenders expect you to have building insurance in place to cover any property against which you secure a loan. Being unable to secure an insurance policy could have implications for your mortgage and could make it more difficult to sell your property.'[1113] After the floods in 2000, an agreement called 'the Statement of Principles' (SoP) was set up between the ABI, the Government, and lending institutions. The agreement committed insurers to provide reasonable cover for people based within high-risk flood areas. This agreement allowed the property market to remain competitive, and prevented the on-set of property blight. For lenders, it offered a great deal of certainty in assessing the risks within areas prone to flooding. After the floods of 2007, the ABI stated that the agreement would not be renewed, and would come to an end in 2013. If another agreement was not made, two hundred

[1111] ibid, para. 4.2.
[1112] Association of British Insurers, '£6.7 million a day in insurance claims from customers hit by the recent flooding' (ABI, 13 November 2014) <https://www.abi.org.uk/News/News-releases/2014/03/6-7-million-a-day-in-insurance-claims-from-customers-hit-by-the-recent-flooding> accessed 18 September 2014.
[1113] Department for Environment, Food and Rural Affairs, *Obtaining flood insurance in high risk areas* (Defra, July 2012) 4.

thousand homes would be without the appropriate insurance cover.[1114] The decision to dissolve the SoP created a great deal of uncertainty for lenders. An article on the CML's website suggested that, 'Uncertainty about the future cost and availability of insurance may affect the ability to sell or obtain a mortgage on a property.'[1115] The article goes on to stipulate that many properties situated within high risk areas could become unsalable on the open market and restricted to cash buyers.[1116] Also, persons who own properties in areas considered high-risk will be unable to obtain or renew their mortgage, which 'may affect the ability of the borrower to continue to meet future mortgage commitments, and the lender's assessment of the affordability of the loan. Uncertainty about the extent to which premiums may rise may make affordability difficult to assess.'[1117] If no further agreement was made after the SoP, some owners within these areas would have to obtain an insurance policy through a specialist broker, leading to the payment of high premium costs for their cover. This would create credit and security risks for bank lenders, as the difficulty in obtaining the appropriate insurance will, 'add to the problems that the market has and may have implications for the value of properties against which loans are secured.'[1118] Even though the SoP has now been repealed in its entirety, the agreement shall be replaced with 'Flood Re'. According to the ABI, Flood Re is:

[1114] '"200,000 homes 'at flooding risk'" (*BBC News; Business*, 31 January 2012) <http://www.bbc.co.uk/news/business-16794696> accessed 13 August 2012.
[1115] Council of Mortgage Lenders, 'Market needs confidence on flooding insurance' (*CML; News and Views*, 2 May 2012) <http://www.cml.org.uk/cml/publications/newsandviews/112/420> accessed 13 August 2012.
[1116] ibid.
[1117] ibid.
[1118] ibid.

> 'a Memorandum of Understanding ('MoU') on how to develop a not-for-profit scheme - Flood Re - that would ensure flood insurance remains widely affordable and available.'[1119]

Flood Re is expected to come into operation by the end of 2015.[1120] When it does, it will aim to protect the ability for properties in high risk flood areas to obtain the necessary insurance by generating money through 'capped premiums', which are set as a levy on Council Tax.[1121] Flood Re has already proved controversial.[1122] For example, the scheme is expected to affect many buy-to-let landlords. Gray, reporting for *The Financial Times*, states that: 'Tens of thousands of buy-to-let landlords face a huge rise in insurance premiums due to government plans to exclude rented homes from its long-awaited flood insurance subsidy fund.'[1123] Also, Flood Re did not initially provide cover to, 'Homes in the highest Council Tax bank H in England'.[1124] Fortunately later amendments to the scheme now means that homes in the highest tax band will be covered.[1125] In response to this amendment, the Chairman of the ABI, Paul Evans, said: 'this is a great result that will ensure continued access to affordable insurance for all who were previously covered by our voluntary statement of principles.'[1126] Even so,

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[1119] Association of British Insurers, 'The Future of Flood Insurance: What you need to know about Flood Re' (*ABI website*, 27 June 2013) <https://www.abi.org.uk/Insurance-and-savings/Topics-and-issues/Flooding/Government-and-insurance-industry-flood-agreement/The-Future-of-Flood-Insurance> accessed 28 November 2013.
[1120] ibid.
[1121] ibid.
[1122] ibid.
[1123] A Gray, 'Buy-to-let landlords fear losing insurance' *Financial Times* (London, 22 January 2014) <http://www.ft.com/cms/s/0/0d982dc4-82b5-11e3-8119-00144feab7de.html#axzz38OO7Tm3R> accessed 24 July 2014.
[1124] ibid.
[1125] S Christie, 'Flood insurance scheme is expanded to include riverside mansions' *The Telegraph* (London, 18 December 2014) <http://www.telegraph.co.uk/finance/personalfinance/insurance/11301860/Flood-insurance-scheme-is-expanded-to-include-riverside-mansions.html> accessed 20 July 2015; and Association of British Insurers, 'All systems go for Flood Re' (*ABI website*, 18 December 2014) <https://www.abi.org.uk/News/News-releases/2014/12/All-systems-go-for-Flood-Re> accessed 20 July 2015.
[1126] S Christie, 'Flood insurance scheme is expanded to include riverside mansions' (ibid).

there is still uncertainty as to how effective this state-funded insurance scheme will be for providing cover to properties based in high risk flood areas. Thus flood risk remains to be an 'emerging environmental risk' which is capable of impacting upon the lender-borrower relationship; it is significant not for lender liability, but for the prospective indirect risks that it can create for financial institutions operating in the UK.

IV. Conclusion

This chapter of the thesis has outlined miscellaneous bodies of law that may create environment-related risks for lenders. From reviewing the different sources of national law, it is clear that lender liability for environmental damage is a relatively low risk for UK lenders. Nevertheless, the credit, security, and reputational risks are more of a threat. There are also 'emerging risks', i.e. climate change and flooding, which are overtaking land pollution as the primary legislative risk for banks. Indeed, the future of environmental due diligence in commercial lending practices is likely to grow and develop to respond to the new threats.

The next chapter (Chapter 4) analyses the overlap between insolvency law and specific environmental regulatory regimes for preventing pollution.

Chapter 4:

Environmental Law and Insolvency

Today, compliance with environmental law and regulation is one of a range of factors that businesses need to consider in their reasonable exercise of due diligence. There are a number of environmental laws, both common law and statute, that can create risks for both lenders and borrowers.[1127] Barlow believes that, 'As the array of environmental issues that are addressed through legislation and case law has increased, there has been an escalation in the range of, and exposure to, environmental liabilities for which a company may be accountable.'[1128] If a borrower creates pollution, being then accountable to remediate that pollution, it may default on the repayment of the loan owed to the bank, and become insolvent. Following a borrower's insolvency, the bank may exercise its securities in order to recover its debt.[1129] Jarvis and Fordham suggest that, 'This is really just one part of the responsible borrower's monitoring function: the all-important question of when to call in the loan, but it gives rise to questions about whether and how to collect the debt.'[1130]

This chapter demonstrates why lenders are relatively unconcerned by the lender liability threat that may be incurred under environmental law following a borrower's insolvency. The chapter therefore assists in answering the overarching research question and sub-question 1. As with the previous two chapters, it shows how the laws

[1127] cf Defra, *Better Regulation* (n 6).
[1128] M Barlow, 'Insolvency: the environmental perspective' (*TheIn-HouseLawyer.co.uk*, 10 June 2009) <http://www.inhouselawyer.co.uk/index.php/environment/7350-insolvency-the-environmental-perspective> accessed 20 September 2014.
[1129] O'Donovan (n 63) 551.
[1130] Jarvis and Fordham (n 51) 77.

relating to environmental protection are currently low risk to lenders; and this explains why the lenders' perceptions of the risks have changed over the last twenty-five years. The chapter also provides strong evidence for why post-loan due diligence is a wholly necessary feature in the banks' environmental risk management. As a consequence it can be linked to sub-question 2, which asks how lenders 'exercise and shape' there due diligence functions. The chapter does three things:

- It evaluates the definition of insolvency;

- It outlines different remedies that are available for lenders when 'taking security'; and finally

- It shows how environmental legislation is currently conceding ground against more established legal regimes, like insolvency.

The first two sections of this chapter provide the background knowledge that is necessary for understanding the later discussion. The third section is most important; it highlights how the old regulatory regime for granting licences to waste operators[1131] (now replaced by the Environmental Permitting (England and Wales) Regulations 2010)[1132] was significantly weakened in a number of judicial decisions, which ruled that insolvency law trumps the ability of the waste regulatory authority to deny the surrender of a waste management licence. Broadly, judgments of the courts in this area have further weakened environmental law in the opinions of the banks (as well as other

[1131] EPA 1990, pt II.
[1132] Environmental Permitting (England and Wales) Regulations 2010, SI 2010/675 (as amended). Part II of the EPA 1990 and the Regulations are outlined, in detail, in Chapter 3.

stakeholders), and represent yet another blow for the redevelopment of environmentally suspect land situated throughout the United Kingdom. The following section considers the definition of insolvency.

I. The Definition of 'Insolvency'

'Insolvency' is defined in section 123 of the Insolvency Act 1986.[1133] There are two types of insolvency.[1134] The first is called 'cash flow insolvency',[1135] which will emerge, 'if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.'[1136] And 'debts' should include both the future and current debts of a company.[1137] A company can be wound-up either by the court, or through creditors' actions. When a company is wound-up by the court, it is called 'compulsory liquidation'.[1138] In accordance with section 123(1)(a) of the 1986 Act, a creditor that is owed a sum of, or exceeding, £750, may serve a written notice to request that repayment be made by the borrower.[1139] If the borrower fails to repay the debt within three weeks, they will be classified as insolvent.[1140] Such an inability to pay debts may indeed be induced by the obligation to remediate pollution (etc.) that was created by the company during the course of its operations. As well as compulsory liquidation, there is also 'voluntary liquidation' to consider here. If a company is unable to pay its debts as they fall due, or a winding-up resolution is passed by the company directors,[1141] it is within

[1133] Insolvency Act 1986, s 123.
[1134] ibid, s 123(1).
[1135] ibid.
[1136] ibid, s 123(1)(e).
[1137] *In re Cheyne Finance plc (In Receivership) (No. 2)* [2008] Bus LR 1562, para 54 (Briggs J).
[1138] Companies House, 'Liquidation and Insolvency' (*Companies House*, February 2014) 18 http://www.companieshouse.gov.uk/about/pdf/gpo8.pdf accessed 24 July 2014.
[1139] Insolvency Act 1986, s 123(1)(a).
[1140] ibid.
[1141] Companies Act 2006, s 283(1): 'A special resolution of the members (or of a class of members) of a company means a resolution passed by a majority of not less than 75%.'

the creditors' rights to wind-up the company voluntarily.[1142] This is achieved in a creditors' meeting, which usually takes place fourteen days after the passing of the special resolution. During this meeting the creditors can question the company directors on the company's failure, and/or cast a vote on whether to appoint a liquidator.[1143] Once appointed, the liquidator will act to wind-up the company, and liquidate any assets owed to the creditors.[1144]

By virtue of section 123(2) of the Insolvency Act 1986, a company may also be classed as insolvent where it is proved to the satisfaction of the court that, 'the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.'[1145] This is referred to as 'balance sheet' insolvency. Significant environmental liabilities could cause a company's balance sheet to show that the company's assets are less than the amount of its liabilities. If leniency is permitted, balance sheet insolvency could be used as an escape route for borrowers that cause environmental damage, and do not wish to take on their contingent and prospective liabilities. The Court of Appeal has taken a narrow interpretation of balance sheet insolvency. Following the case of *BNY Corporate Trustee Services Ltd v Eurosail* [2011] EWCA Civ 227,[1146] before the court provides their satisfaction of a company's insolvency, it must first make sure that the debtor has passed 'the point of no return'.[1147] This is the test to be applied prior to declaring that the debtor is not able to repay the loan. Environmental liabilities may, in some cases, overshadow the assets of some companies; however, this does not always mean that the debtor company has no funds

[1142] Companies House (n 1125) 15.
[1143] ibid, 16.
[1144] ibid.
[1145] Insolvency Act 1986, s 123(2).
[1146] *BNY Corporate Trustee Services Ltd v Eurosail* [2011] EWCA Civ 227.
[1147] ibid, para 48 (Lord Neuberger MR).

left to effectively remediate the pollution that it has caused. The strict test in BNY should prevent companies from opting out of any remediation costs that they are liable to pay.

Balance sheet insolvency has also allowed the escalation of a new phenomenon, 'phoenix companies' (i.e. where the debtor company is wound up, and from its ashes another, almost identical company arises, free from any liability or debt).[1148] In order to prevent the creation of phoenix companies, section 216 of the Insolvency Act 1986 places a restriction on the re-use of a company's name by a director, or shadow director,[1149] at any time in the period of twelve months following the company's liquidation.[1150] If a director, or shadow director, breaches this section, they are liable to a term of imprisonment, a fine, or both.[1151]

The case of *Anslow v Norton Aluminium Ltd* [2012] EWHC 2610[1152] is particularly important to mention in this section. *Anslow* concerned a group litigation order for claims for damages in respect of a private nuisance created by an aluminium foundry. The claimants were awarded damages totalling £1.2 million.[1153] However, in an effort to try and avoid the judgment, the owner put the company into administration. A personal costs order was then issued against the company's managing director,[1154] such an order was later held to be *pari passu* with other unsecured debts.[1155] *Anslow*

[1148] C Nyombi, 'Lifting the veil of incorporation under common law and statute' (2014) Int JLM 66, 74. See also, *Thorne v Silverleaf* (1994) BCC 109.
[1149] Companies Act 2006, s 251; and Insolvency Act 1986, s 251.
[1150] Insolvency Act 1986, s 216(1).
[1151] ibid, s 216(4).
[1152] *Anslow* (n 781) 2610.
[1153] S Tromans, 'Environmental cases to watch' (*Lexology*, 3 February 2014) <http://www.lexology.com/library/detail.aspx?g=56a5da3f-73a4-4685-9cdf-cc4f6aae8f9b> accessed 22 September 2014.
[1154] ibid.
[1155] *Bloom v Pensions Regulator* [2013] UKSC 52.

demonstrates how corporate liquidation will not be tolerated as a means to by-pass liability for environmental damage.

II. Taking Security

A loan is capable of being 'called in' on the demand of the mortgagee.[1156] In the event of default, the mortgagee, or an agent acting on its behalf, may peaceably[1157] enter into possession of the mortgaged property through foreclosure, or by collecting rents from the mortgagor.[1158] The power to take possession is found in Schedule 1 of the Insolvency Act 1986, for example.[1159] However, a lender of a second charge mortgage is required to obtain a court order before possession is taken.[1160] In the environmental context, physical foreclosure is quite ineffective, and 'rarely used' by lenders as a means of taking security.[1161] This is because, as shown in the previous two chapters, the mortgagee could incur principal liability as an owner or occupier of property that is subject to environmental issues.[1162]

Secondly, a mortgagee, or a receiver appointed by the mortgagee, may exercise its power of sale as a way of repaying the mortgage.[1163] This power can derive under the Law of Property Act 1925,[1164] or through specific provisions held within the mortgage

[1156] *Lloyds Bank plc v Lampert* [1999] 1 All ER (Comm.) 161. See also, O'Donovan (n 63) 546.
[1157] *Ropaigealach v Barclays Bank plc CA* [1999] 4 All ER 235.
[1158] O'Donovan (n 63) 544.
[1159] Insolvency Act 1986, sch 1. However, cf AJA 1970, s 36.
[1160] Consumer Credit Act 1974, s 126. See also, *Ropaigealach* (n 1157) 235.
[1161] O'Donovan (n 63) 544.
[1162] Take, for example, the Midland Bank case, where the bank was held liable under Part II of the EPA 1990. See, *Devonshire WRA* (n 652).
[1163] O'Donovan (n 63) 544. See also, *Bank of Baroda v Panessar* [1987] 1 Ch 335, 346 for where a loan condition is breached.
[1164] Law of Property Act 1925, s 121.

document.[1165] There is no duty for the mortgagee to exercise its power of sale over the mortgaged securities 'at any particular time or at all.'[1166] Hood suggests that, 'One reason why a delay in selling a secured asset is not a breach of the mortgagee's duties to the mortgagor, is because nothing has happened to the actual secured asset: it still exists as before, albeit that its value may have decreased (or increased).'[1167] Nevertheless, the mortgagee owes an equitable duty to its mortgagor to take reasonable care to obtain the proper price.[1168] Also, with regards to the receiver, 'he is under no liability to the mortgagor unless he acts in bad faith or fails to take reasonable steps to obtain a proper price at the relevant time.'[1169]

When a mortgagor is in default, the mortgagee may 'appoint a receiver or manager[1170] or an administrative receiver[1171] to collect the secured property, carry on the mortgagor's business and sell the secured property.'[1172] The person appointed to act must be a qualified 'insolvency practitioner'.[1173] There are two types of insolvency practitioner that may be appointed: (1) administrative receivers;[1174] and (2) Law of Property Act (LPA) receivers.[1175] The difference between these two receivers can be identified by their source of appointment. Administrative receivers are appointed by virtue of specific terms and conditions held within a mortgage document; they are also

[1165] O'Donovan (n 63) 569-570.
[1166] *China and South Sea Bank Ltd v Tan* [1990] 1 AC 536, 545 (Lord Templeman). However, there are statutory exceptions, see, Law of Property Act 1925, s 91(2).
[1167] Hood (n 71) 532.
[1168] *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] 1 Ch 949, 967 (Cross LJ). See also, *Standard Chartered Bank Ltd v Walker* [1982] 1 WLR 1410. Further to this read, O'Donovan (n 63) 573.
[1169] *Silven Properties Ltd v Royal Bank of Scotland plc* [2004] 1 WLR 997, 1002 (Lightman J).
[1170] Insolvency Act 1986, s 29(1).
[1171] ibid, s 29(2).
[1172] O'Donovan (n 63) 544.
[1173] Insolvency Act 1986, s 390.
[1174] ibid, s 29.
[1175] Law of Property Act, s 109.

known as 'fixed charged receivers'.[1176] Alternatively, LPA receivers are, as the name suggests, appointed under the Law of Property Act 1925.[1177] The administrative receiver 'is deemed to be the company's agent' under section 44(1) of the Insolvency Act 1986.[1178] Liability will not be transferred to the lender while the receiver acts as agent of the company. However, if a lender controls or otherwise directs the receiver's activities, liability may be transferred to the bank that acts in such a capacity.[1179] According to the *ratio* established in the case of *Standard Chartered Bank v Walker* [1982] 1 WLR 1410, CA (Eng),[1180] even though the receiver is the agent of the mortgagor, a mortgagee that interferes with the receivership may be 'liable for the receiver's conduct',[1181] as the receiver becomes a *de facto* agent of the lender.[1182] However, the agency relationship is 'something of a fiction',[1183] since its 'primary duty is to try to bring about the situation where the secured debt is repaid.'[1184] When appointed, the administrative receiver takes over the management of the debtor company[1185] 'with a view of either selling: (i) the business (or part of it) as a going concern, or (ii) the assets, caught by the floating charge.'[1186] Bryce suggests that: 'In the cases where they may be exercising some management control then they are

[1176] A Salata, 'Fixed charged receivership – ironing out lender and borrower misconceptions' (*Corporate Rescue and Insolvency*, June 2012) 80 <http://www.jordensalata.com/articles/CRI_Jun_F4_Salata.pdf> accessed 9 April 2014.
[1177] Law of Property Act 1925, s 109.
[1178] Insolvency Act 1986, s 44(1). See also, *Gosling v Gaskell* [1987] AC 575 HL.
[1179] M Edwards, 'Insolvency practitioners and environmental law' (2010) 57 Env Law 5.
[1180] *Standard Chartered* (n 1168).
[1181] Hood (n 71) 574.
[1182] ibid. See also, *Standard Chartered Bank* (n 1168); *Medforth v Blake* [2000] Ch 86, 95 (Sir Richard Scott VC); *Silven Properties* (n 1169); and O'Donovan (n 63) 577.
[1183] Hood (n 71) 569.
[1184] ibid, 563. See also, *Silven Properties* (n 1169).
[1185] *Moss Steamship Co Ltd v Whitney* [1912] AC 254, 263.
[1186] Hood (n 71) 564.

obviously vulnerable under certain offences but generally they are not personally liable.'[1187]

Because insolvency practitioners, when appointed, are deemed to act as the agent of the mortgagor, and are sometimes exempt from personal liability under specific statutes, lenders are less likely to incur liability when using receivers to take security and repay their debt. For example, insolvency practitioners are excluded from personal liability under Part IIA of the EPA, i.e. section 78X(3) of the EPA 1990 states that, 'persons that act in the relevant capacity', are exempt from personal liability, and from being found guilty of an offence under section 78M of the EPA 1990. Nevertheless, Egede and Lee suggest:

> 'Insolvency practitioners also need to exercise caution. The turn of the century saw a rash of cases in which insolvency practitioners were fixed with holding waste licences that constituted burdens upon rather than benefits to the companies with which they were dealing[1188]… Although the receiver will act as agent of the company, this does not guarantee freedom from personal liability for environmental offences which occur or continue during the receiver's time in the company. Nor is the position of the receiver or, for that matter, the lender clear at the point at which the company goes into liquidation.'[1189]

[1187] A Bryce, 'Environmental liability: practical issues for lenders' (1992) 7(4) JIBL 131, 135.
[1188] This is discussed in the next section.
[1189] Egede and Lee (n 56) 877-879.

Insolvency within the United Kingdom has become, in many respects, 'Americanised' by the implementation of the Enterprise Act 2002.[1190] Now the proceedings involved in an insolvency claim are more in line with the United States' Chapter 11 procedure. The adoption of the Chapter 11 procedure, in the USA, largely came about in order to protect companies from, for lack of a better word, 'hostile' leverage buyouts (LBOs), i.e. 'corporate raids', 'greenmailing' and 'hostile takeovers', which became a lucrative activity for some of the United States' private-equity companies during the 1980s. Thus, despite the fact that companies are still being wound up all of the time, the option of recovery must at least be visited before the liquidator permits the sequestration of an insolvent company's assets to recompense for its secured creditors' debts. The Act of 2002 therefore provides other avenues to take when companies fall into trouble. Nevertheless, it would seem that, at times of a borrower's insolvency, most banks would prefer liquidation as opposed to recovery options. In interview, Respondent 3 said:

> *I: Do banks often use the practitioners then, as a sort of middleman?*
>
> *R_3: Well, yeah, I mean the banks often end up having to appoint insolvency practitioners. Yeah, but they, frankly, not here, but my experience with other banks is that they would prefer that no money be spent on stuff that wasn't flowing back to them. What the banks want in insolvency is to get paid as much as possible, and I never got the sense that the banks which appointed us were ever interested in protecting people or the environment.*

[1190] Enterprise Act 2002, pt 10. See also, S Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67(2) MLR 247; J Armour, A Hsu and A Walters, 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) 5(2) European Company and Financial Law Review 148.

> *It was often that our insolvency practitioner would say, "Look, I'm personally liable here, I have to do this because I am the officer of the court, and I have to protect myself etc., etc., so tough s**t!" But I know that the banks were p****d off because they wanted as much money as they could get for themselves as possible. In those cases, I didn't get the sense that the banks were particularly accepting, you know, they didn't really acknowledge those types of responsibilities. Without mentioning any names… but yeah… it was a bit of an eye opener at times.*[1191]

The next section analyses the conflict that has emerged between environmental and insolvency laws. It adds strength to the argument that environmental law poses an insignificant direct risk to the financial institutions based in the UK.

III. 'Colliding Statutes'[1192]

In *Re Wilmott Trading Co Ltd (No. 2)* [2000] BCC 321,[1193] Neuberger J, referring to the EPA 1990 (the previous law governing waste management licences) and the Insolvency Act 1986, suggested that, 'This is a difficult area of the law, where one has two colliding statutes'. This section discusses these statutes, and the conflict that has emerged between them.

[1191] Interview with Respondent 3.
[1192] *Re Wilmott Trading Co Ltd (No 2)* [2000] BCC 321, 330 (Neuberger J).
[1193] ibid.

Environmental law has come into conflict with the law on insolvency. In relation to this issue, one banking respondent said:

> *I: I suppose the law sometimes conflicts.*
>
> *R_1: Yes, with insolvency! We get involved when they disclaim it* [e.g. property] *as onerous. That's a big issue in insolvency! A big environmental issue!*
>
> *I: Yes, there are a couple of cases with waste management licences, and whether they can disclaim that as 'onerous property'.*
>
> *R_1: Yes, waste management is quite tricky because of its nature. You've got to be 'fit and proper', and you've got to be able to hold a licence. So, yes, it's a difficult one! What we do in the banks is put environmental risk into practice. And because we take a non-technical view, we are able to sign a lot of cases off. And because I work in recoveries, we know where we lose money.*
>
> *I: So, even high risk can be profitable?*
>
> *R_1: Exactly!*[1194]

Following the above discussion with respondent 1, this section evaluates, specifically, the overlap that has occurred between waste management and insolvency. Having an

[1194] Interview with Respondent 1. Brackets added.

onerous charge on property could have a number of implications for lenders. Land that has a licence attached to it, for instance, will decrease the estate's value, because of the onus that it causes for a future purchaser. This creates security risk for a mortgagee to which the mortgage money is owed. By becoming the owner or occupier of the site, the lender is at risk of adopting any liabilities that are attached to the land, including an onerous environmental licence. This is why lenders will appoint a receiver to manage and sell the property of a mortgagor in default (as described above). To maximise its creditors' interests, the receiver may disclaim any property that it considers to be 'onerous'.[1195] However, this ability has directly conflicted with the regulatory authority's power to surrender licences that it issues under specific environmental regulation.[1196] The following section outlines the law, and the judiciary's interpretation of the law.

A. The Power to Disclaim 'Onerous Property'

Section 178(2) of the Insolvency Act 1986 states:

> 'the liquidator may, by the giving of the prescribed notice, disclaim any onerous property and may do so notwithstanding that he has taken possession of it, endeavoured to sell it, or otherwise exercised rights of ownership in relation to it.'[1197]

[1195] Insolvency Act 1986, s 178.
[1196] EPA 1990, s 35(11).
[1197] Insolvency Act 1986, s 178(2).

In order for section 178 to apply, the liquidator must first establish whether the asset is capable of being disclaimed as 'onerous property'.[1198] Only 'property' pursuant to the definition in section 436 of the 1986 Act[1199] can be disclaimed as 'onerous', namely:

> '"Property" includes money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property.'[1200]

Regulators have suggested that a licence is not property, but merely a form of personal permission to conduct an activity.[1201] The courts have taken a broad interpretation of this definition of property,[1202] and case law has included a 'waste management licence' as property under the definition in section 436.[1203] As a general provision, section 178 of the 1986 Act appoints liquidators for the winding up of a company.[1204] And onerous property, according to section 178(3), is identifiable as any unprofitable contract,[1205] and/or any other property of the company that is unsalable or readily saleable and may give rise to a liability for the payment of money or the performance of any other onerous act.[1206]

[1198] ibid, s 436.
[1199] ibid.
[1200] Insolvency Act 1986, s 436.
[1201] See the Environment Agency's submissions in *Official Receiver (as Liquidator of Celtic Extraction Ltd and Bluestone Chemicals Ltd) v Environment Agency* [2001] Ch 475; and *Environment Agency v Hillridge Ltd* [2003] EWHC 3023 (Ch).
[1202] *Paramount Airways Ltd., re,* [1990] B.C.C. 130, 148 (Sir Nicolas Browne-Wilkinson V-C). See also, *Suwalsky, re* [1928] B & CR 142.
[1203] See for example: *Mineral Resources, re,* [1999] 1 All ER 746 (Neuberger J); *Celtic Extraction* (n 1201); and *Hillridge* (n 1201). While all of these cases agreed that a waste management licence should be classed as property, they differed in their opinions of whether such a provision is wholly disclaimable.
[1204] EPA 1990, s 178.
[1205] Insolvency Act 1986, s 178(3)(a).
[1206] ibid, s 178(3)(b).

B. The Waste Management Licence

It is important to note from the outset that the old licensing regime that issued waste management licences under the EPA 1990 has now been replaced by the Environmental Permitting (England and Wales) Regulations 2010.[1207] The Regulations have consolidated a number of the old systems of licensing into one. A more in depth outline of the Regulations can be found in Chapter 3.[1208] Briefly, the Regulations have replaced waste management licences with environmental permits. While an operator of a facility may apply for a single site permit,[1209] the Regulations also authorise the consolidation of a number of environmental permits.[1210] Thus, it is possible for the same operator to be authorised by more than one environmental permit,[1211] or a facility's 'old permits' can be replace with a single environmental permit,[1212] etc. It is yet unknown whether an environmental permit can be disclaimed in the same way as a waste management licence. This is largely because receivers may no longer be able to disclaim the whole of a consolidated permit. All the same, it is important to evaluate the old system of licensing under the EPA 1990, since this area provides judicial dialogue to suggest that environmental law does not present a significant direct risk to lenders during an insolvency scenario.

Section 35(1) of the EPA 1990 defines a 'waste management licence' as follows:

[1207] Environmental Permitting (England and Wales) Regulations 2010, SI 2010/675.
[1208] Refer to ch 3, pg 163.
[1209] Environmental Permitting (England and Wales) Regulations 2010, SI 2010/675, reg 17.
[1210] ibid, reg 18.
[1211] ibid, reg 18(1).
[1212] ibid, reg 18(2).

> 'A waste management licence is a licence granted by a waste regulation authority authorising the treatment, keeping or disposal of any specified description of controlled waste in or on specified land or the treatment or disposal of any specified description of controlled waste by means of specified mobile plant.' [1213]

This licence was created, therefore, to regulate the activities of waste operators, and to limit any environmental damage that may be caused during their work with controlled waste. Pursuant to section 35(11) of the EPA, 'A licence shall continue in force until… it is revoked entirely by the waste regulation authority under section 38 below or it is surrendered or its surrender is accepted under section 39 below.'[1214] An example of where a waste management licence could be revoked was where it appeared to the regulatory authority, 'that the holder of the licence has ceased to be a fit and proper person by reason of his having been convicted of a relevant offence.'[1215] A licence could only be surrendered if the regulating authority that granted the licence accepted its surrender,[1216] and transferred by the waste regulatory authority where, upon application to the authority, the licensee's transfer was accepted by the regulatory authority.[1217]

The issues surrounding the conflict that occurred between section 35 of the EPA and section 178 of the Insolvency Act have been settled in the courts. Some of the case law is outlined below.

[1213] EPA 1990, s 35(1).
[1214] ibid, s 35(11).
[1215] ibid, s 38(1)(a).
[1216] ibid, s 39(1).
[1217] ibid, s 40(2).

C. Case Law

Before the EPA 1990 was in force, the creditors' interests were, without doubt, the main priority of the liquidators during the winding up of the company. Now public interest and reputational concerns dictate that the environment should also be taken into account in such proceedings.[1218] This has led to a conflict to arise between the two opposing regimes. Shelbourn suggests:

> 'Recent case law has greatly diminished the strength of the powers Parliament originally gave to regulators under Part III of the Environmental Protection Act 1990 to secure the long-term maintenance of waste sites, particularly landfills.'[1219]

Bankers are aware of the conflict that has emerged between the two overlapping legal areas. In relation to this issue, Respondent 3 suggested that:

> *R_3: There's conflict between the Enterprise Act,* [respondent meant Insolvency Act here] *which controls corporate insolvency, and environmental protection legislation. A company can go bust, and disclaim its permit as onerous property, and say, "We're bust! We don't need to do all of the stuff that it says in the permit!" And the Agency goes mad when*

[1218] B Mamutse and V Fogleman, 'Improving the treatment of environmental claims in insolvency' (2013) 5 JBL 486.
[1219] C Shelbourn, 'Waste management sites, insolvency and long term financial provisions – the story continues…' (2004) Jun JPL 697, 707.

> *that happens because it means that they end up having to manage these sites.*[1220]

The interviewee then went on to reference a 'test case':

> *R3: Well, there was some test case where the Environment Agency went after the insolvency practitioner; it was like the administrator, and tried to get the company to pay. So, they won the first case, and then it was appealed, and I think they lost it on the second hearing, or whatever. So, I think the Agency didn't come out on top of that one either, but, essentially, I think the decision was that the Enterprise Act, or insolvency legislation, trumps the Environmental Protection Act. I think that that appears to be the case at the moment.* [1221]

The judiciary has attempted to address the extent to which a liquidator, by virtue of the powers conferred upon it under the Insolvency Act 1986, can disclaim a waste management licence, which is made in accordance with Part II of the EPA 1990, as 'onerous property'.[1222] Prez and Keay suggest that this issue represents more than a legal moot point.[1223] It is 'a conflict of public interest',[1224] which is increasingly dictating that the environment should also now be considered when a company falls into insolvency, and leaves environmental issues *post mortem*.

[1220] Interview with Respondent 3. Brackets added.
[1221] ibid.
[1222] For a definition of 'onerous property', see, Insolvency Act 1986, s178(3). For a definition of 'property', see, Insolvency Act 1986, s 436.
[1223] P De Prez and A Keay, 'Insolvency and environmental principles: a case study in a conflict of public interests' (2001) 3(2) Env L Rev 90
[1224] ibid. See also, A Keay, 'Insolvency Law: a matter of public interest?' (2000) 51 NILQ 509.

1. *Re Mineral Resources Ltd* [1225]

In 1992 Mineral Resources Ltd was granted a waste disposal licence in respect of a landfill site by the local council under the Control of Pollution Act 1974.[1226] With effect from May 1994,[1227] the licence was treated as a waste management licence pursuant to section 35 of the EPA 1990.[1228] The company in question 'ceased trading' on 5 September 1997.[1229] On 18 September a liquidator was appointed to deal with the remaining assets at a creditors' meeting.[1230] During the winding up of the company, the liquidator tried to transfer the company's waste management licence.[1231] It was hoped that someone 'would take a fresh lease of the site'.[1232] Upon the liquidator's failure to transfer the licence, the liquidator then tried to disclaim the licence as onerous property on 3 November 1997.[1233] On 25 November the Environment Agency, replacing the council as the waste regulatory authority,[1234] issued a declaration that the liquidator had no power to disclaim the licence.[1235] Further to this, the liquidator issued a declaration in January 1998 seeking directions.[1236]

Neuberger J recognised that there were two primary legal issues that the court had to determine in this case.[1237] The first issue concerned whether an environmental licence could be described as 'property'.[1238] The second issue for determination was whether a

[1225] *Mineral Resources* (n 1203).
[1226] ibid, 424 (Neuberger J).
[1227] EPA 1990, s 77(2).
[1228] *Mineral Resources* (n 1203) 424 (Neuberger J).
[1229] ibid.
[1230] ibid.
[1231] ibid.
[1232] ibid.
[1233] ibid.
[1234] EPA 1990, s 30(1) and 77.
[1235] *Mineral Resources* (n 1203) 424 (Neuberger J).
[1236] ibid.
[1237] ibid, 423 and 427.
[1238] ibid.

licence could be held as 'property', such that it was capable of being disclaimed as 'onerous property' in accordance with the relevant law.[1239] In this case it was held that, while an environmental licence is 'property' pursuant to section 436 of the EPA,[1240] if there is a 'self-contained and exclusive code' subjecting the licence to such conditions in which it may be transferred, revoked, or surrendered etc., either wholly or in part, and if that code is inconsistent with a code concerning the liquidator's ability to disclaim a licence attached to property, then any liquidator attempting to rely on the code to distinguish the licence by disclaimer will have no recognisable power to do so.[1241] He suggested that, 'it is not particularly surprising, in the present climate, that the public interest in protecting the environment should rank ahead of their [the creditors] interests.'[1242]

In *Mineral Resources* Neuberger J took a 'purposive formalist',[1243] interpretative approach to the two opposing statutes. He favoured the argument submitted by R. Tedd QC, which suggested that specific provisions held within the EPA 1990 had, upon its creation, limited the liquidator's powers in the Insolvency Act 1986.[1244] While this judgment aims to strengthen the enforcement of environmental laws, the widespread use of environmental due diligence in banks means that onerous environmental licences are low risk for mortgagees. In the situation where an onerous licence remains attached to the property following the borrower's insolvency the bank will simply abandon the

[1239] ibid.
[1240] ibid, 429.
[1241] ibid, 438. Neuberger J applied the decision of *Hindcastle Ltd. v Barbara Attenborough Associates Ltd* [1996] 1 All ER 737. In his conclusion, Neuberger J, as he was then called, suggested that his judgment was consistent with the American and Canadian authorities, *viz*: *Panamericana* (1991) 81 DLR (4th) 534 BC; *Re Lamford Forest Products Ltd* (1991) 86 DLR (4th) 534 BC; and *Midlantic National Bank v New Jersey Dept. of Environmental Protection* (1986) 474 US 494.
[1242] ibid, 438. Brackets added.
[1243] See, J Adams and R Brownsword, *Understanding Law* (4th edn, Sweet & Maxwell 2006), ch 4.
[1244] *Mineral Resources* (n 1203) 422 (Neuberger J). See also, *R v Secretary of State, ex p. Hickey* [1995] 1 All ER 479.

property where there is little value in the loan or the property or both. Neuberger J recognises that his judgment could affect 'the orderly and expeditious' liquidation of a company and, in despite of de Garr Robinson's erudite defence, he believed that upholding the law that aimed to protect the environment was in the public interest,[1245] and so made an order to that effect.

2. *Re Wilmott Trading Co Ltd* [1246]

Wilmott Trading (WT), a waste management company, and holder of a waste management licence permitting the processing and storage of scrap metal, ceased trading following a meeting of its creditors in 1997.[1247] While still in creditors' voluntary liquidation, the company's liquidator was served, under the terms of the licence, with a notice to remediate the 1,600 tons of waste that the company created during its operations upon the site.[1248] The company did not have the financial provisions to pay for the remediation costs. The facts of the case state, 'The accounts of the company show that £35,739.57 has been realised from the winding up, that the costs of the liquidation (including legal fees) to date are £23,802.20, and that the total amount claimed by the creditors of the company exceeds £40,000. In these circumstances, Mr Henry considers that the company's funds are effectively exhausted'.[1249] After the regulator served a remediation notice, the liquidator tried to

[1245] ibid, 438.
[1246] *Re Wilmott Trading Co Ltd (No 1)* [2000] BCC 321; *Wilmott (No 2)* (n 1192).
[1247] *Wilmott (No 1)* (n 1246) 323 (Neuberger J).
[1248] ibid.
[1249] ibid.

disclaim the company's waste management licence in 1998, by the power conferred upon it under section 178.[1250]

In *Re Wilmott Trading Co Ltd (No. 1)* [2000] BCC 321 (WT (No. 1)), Neuberger J had to determine, by taking into account the previous *ratio* that he laid down in *Mineral Resources*,[1251] and in respect of the liquidator's declarations submitted to the court, what the company's obligations were under the waste management licence.[1252] In so doing, he had to decide whether the liquidator could prepare the final accounts under section 106 of the Insolvency Act 1986,[1253] in order to allow the company to be dissolved under section 201 of the same Act.[1254] The liquidator also wanted directions as to the existence of the waste management licence prior to the company's dissolution.[1255] In relation to the legal issues, Neuberger J declared that, 'The instant application is, in a sense, a sequel to *Re Mineral Resources Ltd* [1999] BCC 422.',[1256] and conceded that a company can be fully wound up and dissolved, notwithstanding the continued presence of the licence.[1257] He also suggested that, upon dissolution, the licence would cease to exist or remain in force.[1258]

In *Re Wilmott Trading Company Ltd (No. 2)* [2000] BCC 321 (WT (No. 2)),[1259] Neuberger J, rejecting his previous decision in *Mineral Resources*, and in granting the declaration submitted to the court, allowed for the company to be dissolved, and ruled

[1250] ibid.
[1251] *Mineral Resources* (n 1203) 422 (Neuberger J).
[1252] *Wilmott (No 1)* (n 1246) 321 (Neuberger J).
[1253] See, Insolvency Act 1986, s 106(1).
[1254] ibid, s 201(2) states, 'The registrar on receiving the account and return shall forthwith register them; and on the expiration of 3 months from the registration of the return the company is deemed to be dissolved.'
[1255] *Willmott (No 1)* (n 1240), 321.
[1256] ibid, 322.
[1257] ibid, 321.
[1258] ibid, 325.
[1259] *Wilmott (No 2)* (n 1192).

that upon its liquidation the waste management licence would cease to exist.[1260] In his judgment, Neuberger J held that 'in theory' there are three possible options for the existing licence to take upon a company's liquidation: (1) the licence ceases to exist; (2) the property is deemed 'ownerless' and thereafter vests in the Crown *bona vacantia* under section 654 of the Companies Act;[1261] and (3) the licence continues to exist without an owner.[1262] Neuberger J held that in the first two instances licences can be disposed of, since, following the *ratio* in *Mineral Resources*, a waste management licence does not meet the definition of 'property' as outlined in section 654.[1263] Also, with regards to the waste management licence vesting in the Crown under section 654 specifically, Neuberger J held:

> 'First, it appears to me that if a waste management licence was to vest in the Crown in such circumstances, then the machinery envisaged by s.654 would effectively override the provisions of the 1990 Act governing the way in which licences can be transferred or granted… In effect, there would be a vesting of a waste management licence in a party, over whom the Environment Agency would have no control, and who would or might not be a fit and proper person within the meaning of s. 74 of the 1990 Act.'[1264]

In the third instance, Neuberger J believed that this was conceptually problematic, stating that, 'To my mind, the third of the three possibilities I have mentioned can be

[1260] ibid, 322.
[1261] ibid, 331.
[1262] ibid, 330 (Neuberger J).
[1263] ibid, 331.
[1264] ibid.

dismissed without much difficulty. The idea of a waste management licence existing while being vested in nobody is virtually a contradiction in terms.'[1265]

3. *Celtic Extraction Ltd and Bluestone Chemicals Ltd* [1266]

This case concerned two companies in liquidation proceedings.[1267] Prior to their insolvency, and during their operation, the companies had been granted waste management licences. The legal issues for the court to determine were synonymous to the case of *Mineral Resources*,[1268] and Neuberger J applied the *ratio* of that case.[1269] On appeal by the Official Receiver, Morritt LJ gave the leading judgment in the Court of Appeal, with which Roch and Rattee LJJs unanimously agreed. Morritt LJ's judgment partially overruled Neuberger J's decision in *Mineral Resources*. Morritt LJ, taking a narrow approach of the relevant law, held that an environmental licence was transferable as marketable property,[1270] even though it existed in a statutory framework. The waste management licences were thus capable, in certain circumstances, of being disclaimed as onerous property by a liquidator, and this will be the case even if the 'self-contained and exclusive code' that permitted the licence to exist is inconsistent with the legislation which delegates upon the liquidator a power to disclaim onerous property.[1271]

[1265] ibid.
[1266] *Celtic Extraction* (n 1201). For a good over of this case, see, D Case and P De Prez, 'Case Comment: The power of disclaimer and environmental licences' (2000) 2(Apr) Insol L 87; and JH Armour, 'Who pays when the polluter goes bust?' (2000) 116(Apr) LQR 204.
[1267] *Celtic Extraction* (n 1201), 480 (Morritt LJ).
[1268] *Mineral Resources* (n 1203) 422 (Neuberger J).
[1269] See, the interlocutory appeals by Neuberger J in *Celtic Extraction* (n 1201).
[1270] *Celtic Extraction* (n 1201) (Morrit LJ). See also, A Pickin, 'Getting rid of waste management licences' (1999) 12(10) Insolv Int 79.
[1271] This was later applied in *Hillridge* (n 1201) paras 37-38 (Blackburne J).

This case demonstrates a favourable approach for the creditors of an insolvent company. However, such a judgment is bitter-sweet, because, while lenders are protected by this decision, unfortunately environmental concerns do appear to come in at second place. In this case, Morrit LJ favoured the Official Solicitor's argument, and allowed the appeal. He disagreed with the broad interpretation that the Agency submitted, and stated that his reason for doing so was because of:

> '… the very considerable and oft-repeated public policy requirement that the property of insolvents should be divided equally amongst their unsecured creditors. An important aspect of the implementation of that policy is the ability to disclaim.' [1272]

Morritt LJ expresses clearly throughout his judgment that the interests of creditors are the top priority. His decision emphasises a philosophy that endorses the minimisation of risks for creditors in insolvency situations, even though this means setting aside environmental protection during the process. Although this judgment is beneficial for lenders, it is difficult not to feel considerable regret for the loss that the environment suffered in this case.

4. *Hillridge Ltd* [1273]

The case of *Environment Agency v Hillridge Ltd* [2003] EWHC 3023 (Ch)[1274] concerned a trust fund, which was expressly established by a licensed waste company

[1272] *Celtic Extraction* (n 1201) 491, para f (Morrit LJ).
[1273] *Hillridge* (n 1201).
[1274] For a useful review of this case, see, J O'Keeffe and S Boileau, 'Who gets to clean up after insolvency?' (2004) WM 60. See also, Shelbourn, (n 1219) 697; and E de Wit, 'Fate of trust funds on insolvency' (2004) 92(Mar) EB Mag 13

and their regulatory body (the Environment Agency).[1275] The fund would be used in order to provide financial provision for the undertaking of remedial works.[1276] During the company's insolvency the liquidators tried to disclaim the environmental licence under section 178 of the Insolvency Act 1986.[1277] However, the regulatory body argued that the actions of the liquidators disclaimed the licensee's interest in the fund.[1278] Under section 178(6) of the Insolvency Act, any person that sustains loss or damage because of the disclaimer is deemed to be a creditor to the company.[1279] Thus, the regulator made an application to the court under section 112 of the 1986 Act,[1280] in order to determine ownership of the fund after the winding up of the company.[1281] The 1986 Act states that a section 178 disclaimer operates to extinguish the rights, interests, and liabilities of a company or property being disclaimed.[1282] This will come into effect from the date in which the disclaimer is implemented,[1283] and will not affect the rights and liabilities of any other person.[1284]

In answer to the issues surrounding this case, Blackburne J, sitting in the Chancery Division of the High Court, held that where a licence is granted to a relevant person, and a form of financial provision is established which is thereby dependent on that licence to exist, disclaimer of that licence and its liabilities will have the effect of disclaiming all rights and interests in the property.[1285] Property will then be 'ownerless

[1275] *Hillridge* (n 1201), para 2 (Blackburne J).
[1276] ibid.
[1277] ibid, para 10.
[1278] ibid, para 43.
[1279] ibid, s 178(6).
[1280] Insolvency Act 1986, s 112. Section 112(1) states that, 'The liquidator or any contributory or creditor may apply to the court to determine any question arising in the winding up of a company, or to exercise, as respects the enforcing of calls or any other matter, all or any of the powers which the court might exercise if the company were being wound up by the court.'
[1281] *Hillridge* (n 1201) para 2 (Blackburne J).
[1282] Insolvency Act 1986, s 178.
[1283] ibid, s 178(4).
[1284] ibid.
[1285] *Hillridge* (n 1201) para 57 (Blackburne J).

property' and revert back to the Crown as *bona vacantia*.[1286] *Bona vacantia* is an avenue that may be taken where an insolvent company or an intestate estate is left with a piece of onerous property attached to it.[1287] Translated into English, *bona vacantia* simply means, 'empty goods'.[1288] However, the Latin translation actually refers to the process whereby ownerless property from an intestate estate or defunct company is collected by the Treasury Solicitor, and thereafter reverts back to the Crown.[1289] Section 1012(1) of the Companies Act 2006 states that:

> 'When a company is dissolved, all property and rights whatsoever vested in or held on trust for the company immediately before its dissolution are deemed to be *bona vacantia*.'[1290]

Upon a registered company's liquidation, *bona vacantia* will be employed in order to deal with the remaining assets that are left ownerless. Any liabilities held within a particular property are extinguished, and are never deemed to pass into the Crown's possession.[1291] The Treasury Solicitor can disclaim title to the property, or sell it for full market value.[1292] Thus, *bona vacantia* cannot be used as a clean-up tool for environmental pollution, or as a means of dealing with an onerous piece of property, like a waste management licence. Furthermore, Hillridge demonstrates an example of the workings of *bona vacantia*. In this case it was the EA that bore a significant loss

[1286] ibid, para 58.
[1287] *Wilmott (No 2)* (n 1192) 54 (Neuberger J).
[1288] Martin (n 514) 49.
[1289] ibid.
[1290] Companies Act 2006, s 1012. See also section 654 of the Companies Act 1985 for properties vested before 1 October 2009.
[1291] Treasury Solicitor's Department, *Bona vacantia dissolved companies (BVC1)* (*gov.uk*, 6 December 2013) <https://www.gov.uk/government/publications/bona-vacantia-dissolved-companies-bvc1/bona-vacantia-dissolved-companies-bvc1> accessed 22 September 2014.
[1292] ibid.

but this could quite easily have been a private investor, like a bank or other financial institution, which had a joint interest in a fund.[1293]

IV. Conclusion

As well as outlining the definition 'insolvency', and the different approaches that banks can employ when taking possession of securities, this chapter also evaluated the issues that have emerged with two conflicting statutory regimes. In particular, this chapter has assessed the 'collision' that has occurred between the laws governing the power of a liquidator to disclaim onerous property when winding-up a dissolved estate, and the laws relating to the surrender of waste management licences by the waste regulatory authority. The case law in this area shows two judicial approaches. Neuberger J's judgment in *Mineral Resources* provides evidence that laws for environmental protection, as a public policy consideration, should not be weakened by more traditional legal regimes. Following *Mineral Resources*, the case law generally acts in favour of insolvency law, by allowing the insolvency practitioner to disclaim an environmental licence as 'onerous property'. However, further judicial interpretation is now needed, as it is yet uncertain how the judgments evaluated in this chapter apply to the new system of licensing under the Environmental Permitting (England and Wales) Regulations 2010.[1294] Nevertheless, this chapter, by analysing the conflict, has portrayed some of the issues surrounding the relationship between the environment and the economy. It shows that, while repaying the secured debt and maximising creditors' interests are the primary concerns for receivers, there are environmental considerations

[1293] When dealing with Scottish or UK law see, *Re Blair C Nimmo and Gerard A Friar, Joint Liquidators of The Scottish Coal Company Limited* [2013] CSOH 124 (Lord Hodge).
[1294] Environmental Permitting (England and Wales) Regulations 2010, SI 2010/657.

that must also be taken into account. The problem is that specific environmental provisions can sometimes be undermined by more established laws;[1295] and this further explains why environmental legislation is perceived as a low risk by UK lenders.

The next chapter (Chapter 5) outlines the findings that were made in relation to the environmental risks that may attach to a bank when lending to a commercial company.

[1295] Refer to the economic overview in ch 1. This overview shows how the Coalition Government may have weakened environmental law in an effort to make short-term economic gains in a period of austerity.

Chapter 5:

Environmental Risks

This chapter provides an insight into the various environment-related risks that lenders can incur during their commercial loan financing. In so doing, the chapter links to the overarching research question by showing how lenders' perceptions of the threat of the environmental risks have changed since the early 1990s. More specifically, it answers sub-question 1, 'What are the more threatening environment-related risks for the UK lending community?' and sub-question 2, point 2, 'How do banks currently rank the environmental risks in relation to the threat that they pose to the bank?' The interview data that have been analysed suggest that both the environmental risks, and the lenders' environmental due diligence to manage such risks, have developed concurrently over the course of the last twenty-five years. The data also indicate that this development may have been a direct consequence of the increased enactment of specific environmental laws and regulations (e.g. Part IIA of the EPA 1990) which were created during the course of that time frame. This chapter argues that there are four environmental risks that may impact lenders. They include:

- Lender Liability
- The Indirect Risks
- Reputational Risk
- Market Risk

The semi-structured interviews focused specifically on the risks that lenders can incur from land pollution. However, that is not to say that these risks do not have a broader application, applying to other risks, like climate change and flooding. This chapter does two things to answer the key research question and relevant sub-questions: first, it evaluates the different environmental risks identified in the interview data (as above); and secondly, it ranks the risks in accordance with the unique perceptions of the banking respondents.

I. The Environmental Risks

'Risk' is defined as being 'exposed to danger',[1296] and can be calculated by multiplying the likelihood of a threat occurring, with its severity if it does actually materialise. Risk for environmental damage must not be construed as anything but a real threat in modern business practices. If asked what activities are most damaging to the environment, it seems believable that most people in the street would not regard loan financing as an activity that directly affects the environment. It is much more likely that they would emphasis the harm that could be created by the day-to-day operations of heavy industrial sectors. Nevertheless, banks do, although indirectly, affect the protection of the environment; [1297] this is because banks are able to grant finance to clients working in high-risk sectors, and to unsustainable projects. As a consequence, Case suggests that, 'Bankers can (and should) make the identification of environmental risk a *positive*

[1296] JB Sykes (ed), *The Pocket Oxford Dictionary of Current English* (6th edn, OUP, Clarendon Press 1978) 779.
[1297] Hooley (n 52) 405.

aspect of their service to, and relationship with, their customers.'[1298] The following section looks at lender liability for environmental damage.

A. Lender Liability

There are many different types of 'lender liability', which is also described as 'direct risk'.[1299] 'Lender liability' may be defined as:

> '… a convenient rubric under which to group all cases in which banks and other financial institutions have incurred liability as a result of the lending process or ancillary activities. It is not so much a subject as an area of legal practice which draws upon principles from many different sources.'[1300]

This thesis is concerned with lender liability for environmental damage. While much of the liability for environmental issues proceeds from being a mortgagee in possession under English common law, modern prospects of this form of lender liability can be traced back to the US during the 1980s.[1301] In the UK, the risk of direct lender liability for environmental issues has developed since the early 1990s.[1302] Environmental laws and regulations e.g. Part IIA of the EPA 1990, have created a lender liability threat in the UK; however, this is currently considered low risk.[1303] For instance, O'Donovan states, 'In most areas of lender liability the dire prediction of commentators are reinforced by actual cases in which lenders have incurred liabilities. This is not true for

[1298] Case (n 48) 13.
[1299] ibid.
[1300] O'Donovan (n 63) 2.
[1301] Refer to ch 2.
[1302] ibid.
[1303] Case (n 48) 9.

environmental damage.'[1304] Nevertheless, the application of lender liability for environmental damage is dependent upon 'many finely balanced judgments'.[1305] In relation to the liability threat under environmental law, there are numerous trigger terms that may give rise to banks' accountability for environment damage, including: 'causing'; 'knowingly causing'; 'knowingly permitting'; 'owning'; and 'occupying'.[1306] It has already been shown that there are two groups of triggers for establishing liability for contaminated land clean-up under Part IIA of the EPA, i.e. Class A and Class B liability.[1307] From a corporate point of view, one respondent said that lender liability for environmental damage might be incurred by a bank that either participates in the business affairs of a borrower, or has ownership of land, which is subject to regulatory attention or legal action. The respondent commented in answer to a question:

> *I: Okay, so we've talked about risks. Could you describe the different risks that are out there for financial institutions?*
>
> *R_4: Yes. I would say that, principally, from the corporate point of view, there are three or four, I will try to think them through. The obvious one is direct liability, which really only kicks in if you are going to be a controlling shareholder in a business, or, indeed, with real estate, actually owning the asset.* [1308]

[1304] O'Donovan (n 63) 598.
[1305] Hood (n 71) 579.
[1306] The immediate examples relate not to all species of environmental risk but to contaminated land clean-up in particular.
[1307] Refer to ch 2, pp 97-117.
[1308] Interview with Respondent 4.

Liability may be civil or criminal in nature. Also, under specific environmental laws, like Part IIA of the EPA 1990, a person that causes or knowingly permits pollution may incur liability for remediation costs. However, if the person responsible for the pollution cannot be found, liability may attach to the current owner or occupier of the land.[1309] Thus, a mortgagee in possession of polluted land is particularly susceptible. While liability for clean-up costs may be viewed by many bankers as 'inequitable',[1310] it is also unfair for a mortgagee to take its security, and profit from a polluted property, which is, or has the potential to be, significantly harmful. As Hood suggests:

> '… if the legislation is too severe, then lenders may not lend to certain types of industries, as happened in the United States – so-called "dirty businesses", such as, dry-cleaners, printers, big chemical plants, metal bashers, and farmers; on the other hand, if lenders contribute nothing to clean-up costs, and they retain their security, they are obtaining a windfall, at the taxpayer's expense, when they enforce their security.'[1311]

The types of liability are now outlined further below:

Criminal Liability[1312] – While unlikely, if a lender actually causes or knowingly permits pollution, the court may determine that a fine be imposed under the criminal law.[1313] For instance, a person that is found guilty in the Crown Court of unlawfully depositing controlled waste in breach of section 33 of the EPA 1990

[1309] Tromans (n 71) 434.
[1310] Case (n 48) 57.
[1311] Hood (n 71) 579.
[1312] Tromans (n 71) 434.
[1313] Summary conviction in the Magistrates' court may, depending upon the specific legislative provision, lead to maximum fine of £20,000. See, for example, the analysis of s 33 of the EPA 1990 in Chapter 3.

risks incurring an unlimited fine, a term of five years imprisonment, or both.[1314] Even though there is a limit upon the maximum fine that may be issued in the Magistrates' court,[1315] Tromans still suggests that the imposition of such fines can, nevertheless, 'start to mount up quite spectacularly', as one fine for environmental issues does quite often lead to another and another.[1316]

Civil Liability[1317] – Environmental incidents can cause harm to an individual or a group as a nuisance or by breaching the common law duty of care[1318] that is owed between parties.[1319] If this happens, there are a number of remedies that can be used to offer recompense to injured claimants. The most widely used remedies are the award of damages or the issuance of injunctions.[1320] As explained in the common law section earlier,[1321] the award of damages for environmental harm is often difficult to calculate. Despite being difficult to determine, the legal process for gauging claimants' injury in relation to the environmental damage that has occurred is becoming more robust.[1322]

Clean-up Costs[1323] – There are a number of environmental legal regimes that place upon a statutory regulatory body a legal duty to make the polluter pay for the remediation of any environmental harm. Under section 78E of the EPA 1990, the enforcing authority has a duty to require a Class A or Class B appropriate person

[1314] EPA 1990, s 33.
[1315] ibid.
[1316] Tromans (n 71) 434.
[1317] ibid.
[1318] *Donoghue* (n 851) 580.
[1319] Refer to ch 3, pp 132-153.
[1320] *Coventry* (n 782).
[1321] Refer to ch 3, pp 132-153.
[1322] *Anslow* (n 781) 2610.
[1323] Tromans (n 71) 434.

to carry out the remediation of any contaminated land identified and determined within its area.[1324] In some cases, Part IIA liability can lead to significant clean-up costs, as was shown in the *Sandridge* case.[1325]

B. The Indirect Risks

This thesis suggests that, as the law relating to environmental protection in the UK has posed no real direct liability risk for lenders, one of the primary drivers for the financial institutions' increased appetite for environmental risk management may be found in 'the indirect risks'.[1326] Over the course of the last decade, regulatory pressures have increased greatly for many businesses;[1327] and this is particularly true for the more environmentally sensitive sectors that are likely, through the course of their day-to day business operations, to cause environmental damage.[1328]

The data collected in the empirical study show that there are two types of indirect risks: (1) credit risk and (2) security risk.[1329] The reason for grouping these two risks together can be explained by the fact that the vast majority of the banking respondents referred to the two under one heading, so it was only logical to also follow that reasoning in this chapter.[1330] The two risks are defined in more detail below. Respondent 3, who works for a large clearing bank operating in the UK, summed up the two indirect risks, saying:

[1324] EPA 1990, s 78E(1)(a)-(b).
[1325] *Crest Nicholson* (n 510).
[1326] Tromans (n 71) 433.
[1327] Pitchford (n 49) 1171.
[1328] Egede and Lee (n 56) 868.
[1329] Tromans (n 71) 433.
[1330] However, there are many labels for these two risks e.g. 'non-compliance risk' and 'opportunity risk'.

> *R_3: The big one is, uhm, that the client or the borrower, uhm, attracting some sort of liability, which means that, in extremis, the business fails and the bank loses some money, or an environmental incident will impact on the value of the collateral. So, companies often put forward different types of collateral as security, you know, commonly a loan will be secured on the assets of the bank to enforce its security is also impaired. So, if the business goes bust, theoretically, the bank should assess that asset to get its money back. If that asset is worth less, or could be a negative value in some cases, then obviously that's going to have an impact on the bank's ability to cover its bad debt. So, they are the two main ones, which pose a risk. There's (a) an issue which impacts on the business model and means that the company can't service its debt; or (b) there's an issue which impacts on the value of the asset, which are put on the table as collateral.*[1331]

The indirect risks are capable of arising as a consequence of land pollution. Davies uses the Merry Hill Shopping Centre in Dudley as an example of how land pollution can impact the lender-borrower relationship. He notes:

> 'It is widely believed that the American O'Connor Group, a potential purchaser of Merry Hill, pulled out of the transaction believing the land to be contaminated; the area had been used as a general waste tip as well as railway sidings. Within weeks of the O'Connor decision not to proceed,

[1331] Interview with Respondent 3.

> Mountleigh, the existing owner of the site, went into receivership. Mountleigh's lenders found that the value of their security had substantially depreciated. Adverse publicity only succeeding in compounding the problem.' [1332]

In cases where the contamination on a site is particularly severe, a borrower may become insolvent because the land's liabilities outweigh the borrower's net worth, thereby creating a negative equity. If a borrower is having difficulty with its cash flow, there is the risk that the loan owed to the bank may not be repaid. However, a borrower's environmental issues may also impact upon the value of the bank's collateral that is put forward as security against the mortgage. Although there are many different types of security, a piece of land that is identified under the Part IIA regime as 'contaminated land' will inevitably reduce in value.

1. Credit Risk

'Credit risk' is where a borrower, for whatever reason, fails to meet its credit obligations set within the loan agreement before the date of the mortgage's maturity.[1333] This risk can also be described as a 'default risk'. In the environmental context, credit risk may be defined as, 'the weakening of a borrower's covenant to repay debt as a result of environmental costs or liabilities.'[1334] Banks have attempted to manage default events by the use of credit risk modelling, which are alternatively called 'firm-value models'.[1335] Lévy, a world-renowned expert in credit risk modelling, states, 'In general

[1332] Davies (n 49) 16.
[1333] W Schoutens and J Cariboni (eds), *Lévy – Processes in Credit Risk* (1st edn, Wiley 2009), 4.1.
[1334] Case (n 48) 10 and 77. See also, Hooley (n 52) 406.
[1335] Schoutens and Cariboni (n 1333) 4.1.

terms, credit risk refers to the risk that a specified reference entity does not meet it credit obligations within a specified time horizon T.'[1336]

Laws and regulations relating to environmental protection are capable of creating cash or supply pressures for businesses.[1337] Environmental costs can 'translate into indirect, or credit, risks for those banks funding the businesses affected.'[1338] A borrower's remediation costs for contaminated land clean-up are capable of creating credit risk for the bank, to which the mortgaged money is owed. Respondent 5 identifies a number of questions that a bank must ask about its clients, before a loan is approved, in order to reduce this risk:

> *R_5: The credit risk is, really, the ability of a company to repay its loan. So, much like the homeowner, you do the due diligence to make sure that they have enough income to repay the mortgage. When we look at companies borrowing hundreds of millions of dollars, we look at the credit risk. And, of course, the specific part of the analysis would be: Are there material liabilities associated with this company or the products that they intend to purchase? Will it floor them?*[1339]

The data have provided evidence to suggest that the increasing environmental regulation, and the rising rate of insolvency during the age of austerity, have heightened the risk of a lender being left with a borrower in default because of material environmental liabilities. Thus, the prospect of having a non-recoverable loan because

[1336] ibid, 1.1.
[1337] Case (n 48) 11.
[1338] ibid.
[1339] Interview with Respondent 5.

of environmental issues is something that lenders are taking more and more seriously. This finding concurs with the previous academic literature concerning environmental risks and bank lending.[1340] As Hooley suggests:

> 'The cost of environmental compliance may affect the borrower's profitability and hence its ability to service its debt. Strict licensing regimes control various areas of commercial activity where there is a recognised risk of pollution. The compliance costs of meeting the conditions attached to such licences can be high.' [1341]

Nevertheless, the interview data portray that the banks' ability to analyse credit risk for environmental concerns is becoming more and more fine-tuned. In order to reduce the threat of credit risk, it is crucial for banks to find good commercial clients whose operations are environmentally, socially, and ethically sound. Some banks are taking innovative steps to calculate the credit risk that may be caused by the environmental issues of their borrowers. One major clearing bank in the UK has, quite remarkably, created a screening tool that assesses an individual loan's credit risk.[1342] The tool analyses any future environmental liabilities that may prevent a borrower from repaying the loan.[1343] Environmental risks that are identified by the screening tool are referred to the bank's in-house environmental risk management team, which are experts in this specialised area of banking risk.[1344] This modern way of processing may indicate an age where the entire environmental risk management of banks is conducted in-house,

[1340] Refer to ch 1.
[1341] Hooley (n 52) 406.
[1342] Lloyds Banking Group, '20% By 2020 – Our Environmental Action Plan: one year on' (*LloydsBankingGroup*, 2012) 18 <http://www.lloydsbankinggroup.com/globalassets/documents/our-group/responsibility/reports/climate_magazine.pdf> accessed 15 December 2014.
[1343] ibid, 18.
[1344] ibid.

thus removing the current reliance on the externally commissioned, expertise of consultants and auditors.

2. Security Risk

Security risk is somewhat different to credit risk.[1345] In order to protect their interests, lenders will often collateralise property, whether tangible or intangible, as a secured interest under the mortgage.[1346] Where a borrower defaults on the repayment of the mortgage money, lenders may 'exercise their security'[1347] in order to recover any debt that is owed to the bank during the orderly winding up of a company who is a client of the bank.[1348] However, land that is taken as a secured interest is capable of depreciating in value because of contamination. Tromans says that, 'More specifically, the value of property as security may be affected by its physical condition, and specifically the problems of contaminated land.'[1349] Further to this Case states, 'Major financial institutions in the USA, Switzerland, Germany and the UK have each suffered losses counted in the tens of millions of dollars as a result of contaminated security.'[1350] Respondents 6 and 12 describe how lenders still fear the security risk that may occur because of a property being determined as contaminated land under the Part IIA regime:

> *R_6: There's also the value of the collateral, as the property may be worth much less from the appraisal value, or it may be so contaminated that the*

[1345] Tromans (n 71) 433.
[1346] O'Donovan (n 63) 551.
[1347] Refer to ch 4, pg 197.
[1348] However, corporate insolvency represents a sufficiently risky period for lenders.
[1349] Tromans (n 71) 434.
[1350] Case (n 48).

> *collateral is worth nothing at all. We've seen that on a couple of occasions.*[1351]

And,

> *R_{12}: There's also then, from contaminated land, the risk that, uhm, they will be left with something on their books, if a customer defaults on it, and the ability to sell on that land.* [1352]

Land value is particularly sensitive to contamination and associated environmental liabilities and risks. Where contamination is identified upon land, the property will subsequently lose market value, and, depending upon the extent of the pollution that is present on the site, may even be blighted to such a degree that it is completely unsaleable. As one may imagine, a piece of land will be worth considerably less than the bank's original valuation if, after the loan is approved, it has been identified and determined as contaminated land by a local authority under Part IIA of the EPA 1990. Consequently, environmental liabilities are contributing to the increasing number of orphan sites that are situated around the UK.[1353]

C. Reputational Risk

For this thesis, reputational risk describes the threat that may be attributed to the bank because it has financed an environmentally contentious client or project. Reputational

[1351] Interview with Respondent 6.
[1352] Interview with Respondent 12.
[1353] Egede and Lee (n 56) 868.

risk is, therefore, perceived as a form of guilt by association, as one banking respondent pointed out in interview:

> *R_3: The other issue is, you know, a bank can be guilty by association. So, if, uhm, if a company is proven to have created some environmental problem, people will often look at the other organisations that support that company. So NGOs will often target the banks and say, "You're financing these guys, so you have responsibility here!"* [1354]

The data show that the bank's reputation is its most important asset.[1355] Newspaper headlines like, 'Deutsche Bank refuses to bankroll Barrier Reef port expansion',[1356] evidences the fact that banks are concerned about the potential reputational risk that may materialise from being associated with an environmentally harmful client or project. And, more significantly, the above headline shows that banks are actually refusing to finance projects that carry significant reputational implications for the bank.

As a part of its overall corporate governance framework, the modern bank must now consider whether its lending will create environmental harm. Risk management teams must now ask whether the bank will appear on the front cover of *The Financial Times* or *The Wall Street Journal* because its lending is a subject of environmental contention. This certainly would not have been the case a little more than ten years ago. This may be because corporate governance, generally, is softening its policies. For instance, Case suggests that, 'The subject of business ethics and mortality has been rising up

[1354] Interview with Respondent 3.
[1355] infra ch 8.
[1356] J Smith, 'Deutsche Bank refuses to bankroll Barrier Reef port expansion' (*FT.com*, 23 May 2014) <http://www.ft.com/cms/s/0/c616fd0a-e249-11e3-89fd-00144feabdc0.html#axzz34vRtcdW9> accessed 17 June 2014.

boardroom agendas for some time. Gone are the notions that companies are inanimate legal entities and therefore amoral, and making a healthy profit and behaving unethically are mutually exclusive aims.'[1357]

However, the reputational risk relating to contaminated land is not usually that significant; of course, the reputational risk could be severe if the land affected by contamination causes significant harm to human health, for example. Therefore, when the banking respondents referred to 'reputational risk', they were talking generally about the reputational harm that banks can incur during project finance, which also covers redevelopment projects on contaminated land. However, it is noteworthy that the definition of 'reputational risk' for this thesis covers all types of reputational risk that can be incurred by banks, and not merely risk associated to project financing. Project financing is usually a risky business because information about such projects are normally easily accessible within the public domain. This gives non-governmental organisations (NGOs) and campaign groups a wide degree of scope to take stock of the banks' present business activities, and initiate an assault upon any banks that are involved in a controversial project with which the NGOs disagree. This is why, as Respondent 3 suggested above, this risk is often viewed as a form of 'guilt by association'.

D. Market Risk

Some of the interviewees spoke about a fourth risk that banks may incur because of environmental concerns during their lending activities, i.e. 'market risk'. This section

[1357] Case (n 48) 11.

of the chapter briefly describes this fourth risk, and, in so doing, outlines the author's reasoning for not presenting the threat as a primary environmental risk in commercial bank lending. 'Market risk' may be defined as:

> '… the risk of losses in on and off-balance sheet positions arising from adverse movements in market prices. From a regulatory perspective, market risk stems from all the positions included in banks' trading book as well as from commodity and foreign exchange risk positions in the whole balance sheet.'[1358]

This risk was depicted well by Respondent 13 in interview:

> *R_{13}: So, I would agree with those three categories. We as a company… you could also add market risk, because if we do not value environmental risks in our evaluations, when we bring companies to a market, and to the IPO* [initial public offering], *if we IPO a company, and we did not notice in our due diligence specific risks within that company, there might be other types of risks that will affect the valuation of the company on the stock market.* [1359]

In accordance with Respondent 13's interview extract, market risk occurs where a bank is bringing a company to a particular market through an initial public offering or merger and acquisition etc., and the bank fails to identify environmental risks in its valuation of the company. Specifically, the issue here is one relating to the bank's prospective

[1358] European Banking Authority, 'Market Risk' (*European Banking Authority*, no date) <https://www.eba.europa.eu/regulation-and-policy/market-risk> accessed 24 September 2014.
[1359] Interview with Respondent 13. Brackets added.

liability to investors if such risks are not disclosed. This is because environmental issues affects the company's flotation, and the investors' capital is lost as a consequence. It is important to note that only a small amount of data were collected on this type of risk. Consequently, market risk has been omitted from the 'risk ranking' in this chapter because it is, in the author's personal opinion, very unlikely to occur as a result of land pollution.

II. Ranking the Risks

The interview data suggest that the greatest environmental risk is the reputational damage that can materialise for a bank because of their clients' environmental issues. The data also show that, at the moment, the lowest risk is direct lender liability. This finding corresponds to the limited amount of case law that concerns direct lender liability for environmental issues. After completing a thematic analysis of the data, the 'risk ranking' goes as follows:

- Lender Liability – Low Risk
- The Indirect Risks – Medium Risk
- Reputational Risk – High Risk

As noted above, market risk has been omitted from this risk ranking because it is a highly unlikely risk in the environmental context. This section begins by evaluating the threat of lender liability for environmental damage. By providing a contemporary

ranking of the threat of the environmental risks, the section responds to the overarching research question and sub-question 1.

A. Lender Liability

The data show that lender liability for environmental damage is perceived as low risk by financial institutions in the UK. Comparing the interview data with some of the older academic literature portrays how significantly perceptions of lender liability for environmental damage have changed over the last twenty-five years. For instance, in an article that he composed in 1990, Tromans suggested that:

> 'Perhaps the greatest fear of all for lenders is that of possible primary liability in the event that they seek to realise their security.' [1360]

Similarly, in a paper written in 1993, Parker and Welch stated that:

> 'Of the many environmental-related issues facing the community, one of the most pressing is that of mitigating the effects of past pollution… It appears that the problem of being unable to make the polluter pay because the polluter cannot be found is to be solved with the theory that those in the community with the largest revenue base should be required by legislative means to take the original polluter's place. Lenders seems to have been

[1360] Tromans (n 71) 434.

universally identified as a group with sufficient capital to take on this role.'
[1361]

While it has been previously established that the greatest threat of direct liability for lenders in the UK presently comes from Part IIA of the EPA 1990, Chapter 2 of this thesis shows that, due to the regime's poor implementation and lack of enforceability, Part IIA liability is a decreasingly low risk.[1362] Legal academics and practitioners are no longer likely to present Part IIA as 'the greatest fear of all for lenders.' The overall perception towards the threat of lender liability for environmental damage has changed; and this changing perception is supported by the response that one interviewee gave when asked about the present threat to banks for the payment of remediation costs under the Part IIA regime:

I: What about direct lender liability risk, where the bank has to pay for the clean-up costs?

R_3: I'm not aware of any instance where a bank, uhm, has been forced to pay for clean-up. That just, as far as I know, hasn't happened. I mean the, uhm, the contaminated land regime, which came in in 2000, you know, hasn't driven a lot of legal cases, uh, the issues tend to be sorted out because everyone's aware that there is a legal framework, but they try to do what they can to make sure that it doesn't go down that route. Obviously,

[1361] Parker and Welch (n 72) 217.
[1362] Refer to ch 2.

> *there is an indirect impact if the bank's client suddenly has to pay for something that they weren't expecting to pay for.*[1363]

A surprising result was that, when asked to categorise the various risks, some interviewees failed to mention direct liability altogether, which demonstrates just how insignificant the threat is for commercial lending practices. When assessing a particular risk, banks tend to analyse both the likelihood of a risk's occurrence, alongside the severity of the damage that may be incurred if the risk does actually materialise, no matter how unlikely. When evaluating the likelihood of a lender being made liable under the Part IIA regime, it is possible to rank this category of environmental risk as low. However, direct lender liability does appear to be a more significant risk when one assesses it in relation to the severity of the harm that can be incurred. The following interview extracts may be used as examples to put emphasis on this point:

> *R_{10}: Liability risk, I guess, it depends how the deal is structured, right. If you end up having a client… well you may know more than me about this, uhm, if we take over a company that has significant liability due to land contamination, then we do end up having a liability risk, I guess.* [1364]

Also,

> *I: Excellent, and are there any risks that are more of a threat than others?*

[1363] Interview with Respondent 3.
[1364] Interview with Respondent 10.

> *R_{11}: Sure, I would tend to say that, in terms of… in terms of the severity… contamination liability tends to be the largest because it can cause the most substantial single impact to the organisation.* [1365]

And,

> *R_{12}: Well, I think contaminated land is probably the biggest threat, partly because it's the biggest unknown, and because of the of the context in which contaminated land risk is assessed, uhm, results from all are site specific, even if you have those results, but, a lot of the time you don't have very much to go on, so often it's a very big question mark.* [1366]

Even though lender liability for environmental damage is now considered low risk, the likelihood of a bank being made directly liable for environmental pollution should still remain as a 'theoretically possibility'.[1367]

B. The Indirect Risks

There was a general consensus between the interviewees that lenders perceive the indirect risks (i.e. credit and security risks) to be more of a threat than lender liability. However, while the indirect risks are ranked higher than direct risk, the majority of the interviewees proposed that banks are less concerned about these risks than the threat posed to them by reputational risk, especially when lending on environmentally and socially contentious projects. Such a risk ranking should be expected, since, upon a

[1365] Interview with Respondent 11.
[1366] Interview with Respondent 12.
[1367] Egede and Lee (n 56) 868.

portfolio basis, lenders would not suffer a huge financial injury from the indirect risks that may occur on individual loans. On the other hand, the reputational risk that may be created by being in association with a company that has created significant environmental damage may be much more harmful to the bank's future profitability. When asked to rank the risks in order, two respondents commented:

> *R_{10}: Okay, well the risks are many. The two biggest ones are reputational risk and credit risk.*[1368]

And,

> *R_{13}: Currently, I would rate reputational risk higher than… well… first – reputational risk, secondly – credit risk, thirdly – liability and market risk.*[1369]

Even though the indirect risks are currently ranked lower than reputational damage, it is still a threat that banks need to consider during the implementation of their environmental due diligence functions. This must be done both before and after the grant of loan finance, as Chapters 6 and 7 demonstrate.

In the environmental context, the circumstances in which the indirect risks can occur for banks are numerous. For example, a borrower may incur criminal and/or civil liabilities for non-compliance with a regulatory regime, or a borrower may be served with a remediation notice, or a borrower may become insolvent and the bank is then

[1368] Interview with Respondent 10.
[1369] Interview with Respondent 13.

left with a bad asset on its books. When determining the greatest threat between credit risk and security risk, the responses given by the interviewees were mixed. Some interviewees suggested that credit risk was the greater threat of the two:

> *R_5: Certainly, the credit risk would be the larger because that impacts, directly, a company's ability to pay back a loan.* [1370]

Conversely, some believed that security risk should be classed as the most problematic:

> *R_6: I think the biggest threat is probably the damage done to the value of the collateral, because most appraisals are done on the basis that the property is clean. That may, or may not, be the case; and if it's not clean, then that value of the collateral may be much more diminished than we were thinking it is. So when you realise on property – say it's worth $1 million – realise on the property, and we can only get $700,000 back because that's all we can sell the property for, then, typically, that's not going to cover our loan. And that happens more often than not.*[1371]

Ultimately, when viewed upon a case-by-case basis, the two risks can be just as threatening. Fortunately, the likelihood and severity of both credit risk and security risk can be mitigated through the banks' use of environmental due diligence, and this is especially so in relation to land affected by contamination. Indeed, with some types of lending practice (such as, syndicate loans, initial public offerings and mergers and acquisitions), the indirect risks caused by environmental concerns pose a very unlikely

[1370] Interview with Respondent 5.
[1371] Interview with Respondent 6.

threat to bank lending. Certainly, it is only in the situation where a bank lends large sums of its own money that these two risks can become highly troublesome.

C. Reputational Risk

Reputational risk is presently viewed as the greatest environment-related risk to commercial loan financing activities. As mentioned above, the increasing threat of reputational damage within the financial world can be attributed to the rise in societal pressures, and concerns surrounding environmental and social welfare. With regards to reputational risk, Respondent 10 suggested that:

> *R_{10}: Because of society's expectations – because of NGOs' expectations keeping raising awareness – because banks also do not like to think of themselves as someone as an organisation that turns a blind eye – and because of that you have reputational risk. Environmental risk is probably, much often, triggered by reputational risk, if that makes any sense. Credit risk is happening as a result of environmental impacts from clients is very real; it can be very significant; but it is much rarer. Reputational risk is much more frequent in association with, uhm, environmental impacts.* [1372]

One of the greatest problems with this type of environmental risk is that it is extremely difficult to calculate. This is because the risk of a bank receiving reputational damage for environmental issues is uncertain until it actually materialises. For large projects of

[1372] Interview with Respondent 10.

$10 million or more, the Equator Principles (EP) may be used to reduce the severity of the threat posed to lenders by reputational risk.[1373]

The EP are discussed in more detail in the following chapter.[1374] The EP are a voluntary set of principles that aim to act as a 'common baseline and framework'[1375] for financial institutions that lend to major projects. Chapter 7 argues that the EP have acted as a primary driver for the financial institutions' use of environmental risk management.[1376] However, despite all of its positive attributes, some view the EP as a potential source of primary liability for the Equator Principles Financial Institutions (EPFIs). This may be increasingly true under the new EP III framework, which sets out broader methods for categorising, auditing and assessing an EP project. Such reasoning is adopted by Torrance, who suggests:

> 'The reality is, wherever EPFI are auditing and assessing legal and regulatory compliance of their borrowers and even suggesting management approaches through the Action Plan and monitoring and review processes as "partners" with their borrowers, there will exist the possibility that an EPFI could be accused of a regulatory offence, along with their borrowers. That means that both the EPFI as corporations, as well as individual employees, officers or directors, could find themselves the subject of a regulatory prosecution in relation to an EP project.' [1377]

[1373] *The Equator Principles* (*EP*, June 2013) 3 <http://www.equator-principles.com/resources/equator_principles_III.pdf> accessed 12 August 2013.
[1374] infra, ch 7.
[1375] *EP* 2013 (n 1373) 3.
[1376] infra, ch 7.
[1377] M Torrance, 'Managing Lender Liability in the Equator Principles Implementation – Regulatory Offences' (*Lex Sustineo*, 30 May 2013)

Within twenty-first century banking, the ability to calculate and capture the reputational damage that might be incurred when lending has proven to be particularly troublesome. During the course of funding trans-national corporations, the qualitative data have shown that it is very difficult for a bank to 'hypothecate' the money that is lent to an individual project or cause; and this is particularly so in syndicated loans. Large corporates often operate on a global scale, and the projects that they are involved in at any one time can be many, and will vary considerably. Simply because a lender has lent money to a borrower that operates trans-nationally, does not mean that the bank endorses every project in which that borrower is involved. Even so, NGOs will often tar lenders with the same brush as their clients. In their interview, Respondent 11 spoke freely about the bank's difficulty with the hypothecation of funds in this regard:

> *R_{11}: So you may lend money to the corporate body, say, based in London – headquartered in London. And that money is transferred into, you know, their London liquidity accounts. But then they may undertake activities globally, uhm, and, therefore, a favoured NGOs tactic is to hypothecate all of the financing that a financial institution provides to the one, particularly, contentious project. We saw this as an NGOs tactic with the tar sands in Alberta, in Canada, where there was a NGI report that was issued that listed all of the banks involved in financing, and then assumed that the gross financing sums – the gross lending sums – that were lent to corporate entities, like, say BP, who had operations there, were all going to support that. So you end up with multi-billion pound/dollar sums that were supposedly being lent to support tar sands, and the reality, of course, was*

<http://lexsustineo.blogspot.co.uk/2013/05/managing-lender-liability-in-equator_30.html> accessed 12 August 2013.

> *that the money that was being lent was going to support BP's global treasury, uhm, and very little, if any of it, was making its way to Canada. As a financial institution, you can't track that. It is impossible to differentiate between which particular. It's like taking a cup of water out of a stream: what portion of the money that goes in at this end is yours that comes out of the other end?* [1378]

Because reputational harm is difficult to calculate, assess and evaluate, there is a great deal of uncertainty throughout the lending community as to the future of this form of environmental risk. This is why it is ranked as the greatest threat. For example, some of the bankers that were interviewed have already began to question whether, in the future, lenders would be obliged to assess the environmental impacts that their individual loan financing activities have in relation to the environment. If this does actually materialise as a *de facto* requirement for social, ethical, and environmental disclosure,[1379] it may be that the banks will have to evaluate things like the carbon exposure that their individual transactions generate. According to the interview data, reputational risk has replaced lender liability for environmental damage as both the most probable and significant environmental risk within commercial loan finance. As will be discussed in Chapters 6 and 7 on environmental due diligence, it can also be categorised as the most prominent driver for the banks' continued use of environmental risk management in modern corporate banking.

[1378] Interview with Respondent 11.
[1379] Egede and Lee (n 56) 868.

III. Conclusion

This chapter of the thesis has portrayed the different types of environmental risks that lenders may experience in their commercial loan financing. Following a general description of the environment-related risks that were identified in the interview data, an account of the changing perceptions towards these risks was provided. The data show that lender liability is low risk, and lenders rank reputational risk as the greatest threat to their commercial loan financing activities.

The next chapter (Chapter 6) evaluates the due diligence methods used by banks to characterise and assess environmental risks before and after the loan is contracted.

Chapter 6:

Environmental Due Diligence

The previous chapter (Chapter 5) presented an overview of the environmental risks that banks may incur during their loan financing to commercial customers. It seems necessary, therefore, to follow with a chapter on the different due diligence techniques that financial institutions use to manage and assess such risks. In accordance with the data analysed in the semi-structured interviews, this chapter of the thesis portrays the lenders' present use of environmental due diligence when lending to commercial customers. The necessity and purpose of this chapter lies in its explanation of the different types of due diligence that are currently employed by bank lenders. The overarching research question asks, '…what are currently the primary drivers for the use of environmental due diligence'? This key question is supplemented by sub-question 2 which relates specifically to the practise of environmental due diligence in banks. Accordingly, Chapter 6's relevance to the overarching research question and sub-question 2 is in its demonstration that an environmental due diligence culture has developed within the risk management frameworks of the banks. The next chapter (Chapter 7) also concerns environmental due diligence; it outlines the interviewees' opinions of what has driven this form of due diligence to develop over the last decade. The following section analyses the beginnings of environmental due diligence in banks.

I. The Beginnings of Environmental Due Diligence in Banks

Lenders cannot afford to ignore the threat of 'environmental liability'.[1380] Thus, environmental due diligence is now an accepted feature within the world of commercial finance.[1381] When contracting a loan or taking security, it is important that lenders understand the risks that may be incurred.[1382] The Organization of Economic Cooperation and Development (OECD) provides a general, but nevertheless useful, definition of due diligence in a Report that it published in 2013. The Report suggests that 'due diligence' is:

> 'the process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems.'[1383]

In the environmental context, due diligence describes the processes and mechanisms that are undertaken in order to avoid the materialisation of any future environmental risks or liabilities, which may arise out of a transaction.[1384] It is a system of 'due merit

[1380] Hood (n 71) 631.
[1381] See, P Yeoh, 'Socially responsible investing: legal and related challenges' (2014) 35(2) Comp Law 35; and T Slapper and T Hall, 'The Triple Bottom Line: What is it and how does it work?' (2011) Indiana Business Review 1.
[1382] Jarvis and Fordham (n 51) 165.
[1383] Organization of Economic Cooperation and Development, 'Environmental and Social Risk Due Diligence in the Financial Sector: current approaches and practices' (OECD, May 2013) 14 <http://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/2013_WS1_1.pdf> accessed 6 October 2014. See also, N Azimah Abdul Aziz, 'Managing corporate risk and achieving internal control through statutory compliance' (2013) 20 JFC 25, 26.
[1384] ibid.

or care',[1385] and is particularly important when dealing with clients that work in 'hazardous industries or operations'.[1386] Such an observation is verified by Seiler, who suggests that, 'In the last decade, potential liability for environmental contamination has grown tremendously, affecting parties not normally involved in the generation, treatment, storage, disposal, or transportation of hazardous wastes.'[1387]

Environmental due diligence is a risk management tool that may be used by banks to improve their perceptions in the public eye, to better understand clients, and to comply with environmental supply chain management systems etc. As well as banks, environmental risk management has also become a necessary pre-requisite for many borrowers, and this is especially so for those operating in sectors that are considered to pose a high risk to the environment. Roulac suggests that, while environmental risks were once used as 'a prime example' for economists to demonstrate how market-pricing mechanisms are inadequate for calculating the external costs that may be present on financial transactions,[1388] now the mechanisms are much improved, and, 'have dramatically enhanced the significance of environmental considerations.'[1389] The growing environmental threats have allowed a culture for environmental risk management to develop throughout business.[1390] In relation to lenders, this has meant that it has become necessary for banks to assess any such risks that they may incur by virtue of their loan financing to commercial customers.[1391] As lending institutions have

[1385] C Corino, 'Environmental Due Diligence' (2000) 9(4) European Energy and Environmental Law Review 120.
[1386] O'Donovan (n 63) 625.
[1387] S Seiler, 'The Environmental Due Diligence Defense and Contractual Protection Devices' (1988) 49(6) La L Rev 1405.
[1388] Roulac (n 68) 139.
[1389] ibid.
[1390] However, environmental legislation may no longer be perceived as a significant driver for environmental due diligence in banks. The Coalition Government is currently running a one in / one out system of regulation under the red tape initiative.
[1391] Seiler (n 1387) 1405.

evolved and developed over time, so have their techniques for managing and mitigating risks created during the course of their business operations.[1392] Evans argues that, before the threat of the non-financial risks emerged, banking due diligence had been directly influenced by the concept of *caveat emptor* ('let the buyer beware'),[1393] and also the threat posed to lenders by the fraudulent behaviour of their clients.[1394] In line with Evans' reasoning, this chapter argues that, since 1990, environmental issues have also been influencing the growth and development of environmental due diligence as an essential condition of lending to commercial customers in the UK.

The interview data suggest that environmental due diligence in commercial loan financing first emerged in the UK in the 1990s. Before the inception of specific environmental laws into the British legal system, it would have been increasingly unlikely to find this type of due diligence being carried out by a bank considering granting a loan to a commercial customer. Respondent 4 highlighted this point:

> *R_4: I started to remember that happening in the 1990s. Before that, I think it is probably increasingly unlikely that the banks did very much.*[1395]

And, Respondent 7 also suggested that:

> *R_7: Yeah, the 1990s was really the growth period for due diligence.*[1396]

[1392] A Evans, 'Due diligence: the English way' (1995) 6(6) ICCLR 195.
[1393] Martin (n 514) 65. 'Caveat emptor' is defined as, '[let the buyer beware] A common-law maxim warning a purchaser that he could not claim that his purchases were defective unless he protected himself by obtaining express guarantees from the vendor.'
[1394] Evans (n 1392) 195. See also, J O'Keeffe, 'Environmental issues in corporate transactions in the United Kingdom' (1999) 10(12) ICCLR 343, 347.
[1395] Interview with Respondent 4.
[1396] Interview with Respondent 7.

Although this will be discussed in more detail later on within the following chapter, the primary legislative driver for the origins and expansion of environmental due diligence in UK banks was Part IIA of the EPA 1990 (however, the other risks within environmental law have also contributed to this paradigm).[1397] When Part IIA was first enacted, it created a fear which spread throughout the lending community; and it was the fear of incurring liabilities for pollution that forced financial institutions to develop due diligence methods. The empirical data show that, over the last ten years, lenders have become much more proactive in establishing methods that aim to assess the environmental issues that may either pose a direct risk to them, or affect the future creditworthiness of their commercial customers. Bellis and Deceleve portray the lenders' function in relation to the environment. They ask:

> 'How do environmental issues affect the way bankers go about their profession? As organisations, banks are not really affected by operational problems directly related to the environment. As lenders, however, they are present in all sectors of the economy. The financial services industry certainly has a major role to play in environmental issues.' [1398]

While legislative exposures made due diligence techniques for reducing environmental risks a necessary feature within bank lending to commercial clients, it is apparent that the legislative basis is no longer having the same effect now.[1399] The following section

[1397] Refer to ch 7.
[1398] M Bellis and X Decleve, 'Banking services and the environment' (1993) 4 IBLJ 391.
[1399] See the next chapter, which appraises the various drivers for the continued growth of environmental due diligence in modern financing activities.

looks at the different types of environmental due diligence that the banks' environmental risk management teams use to manage risks.

II. The Different Types of Environmental Due Diligence

This section of the chapter evaluates the different stages at which environmental due diligence techniques may be deployed. It therefore provides an essential link to sub-question 1, point 1, i.e. 'What are the main due diligence techniques used by lenders to manage environmental risk?'

There are two primary stages in which due diligence may be carried out.[1400] The first occurs before the loan has been granted,[1401] and, as a consequence, may be described as 'pre-loan due diligence'. It is only once a loan has been approved that the next stage of due diligence kicks in;[1402] this is referred to as 'post-loan due diligence'. Even though different due diligence techniques are used at the two stages of risk management, the level of control that a lender has over its borrowers must be kept to a minimum at all times. A lender with a significant degree of control over the business affairs of its customers is much more likely to incur lender liability as a person that either caused or knowingly permitted environmentally damaging activities that resulted in pollution.

[1400] E Bodson, 'Prevention of lender liability risks for environmental damages' (1993) 4 IBLJ 467, 473.
[1401] ibid.
[1402] ibid.

A. Pre-loan Due Diligence

Pre-loan due diligence refers to the methods of risk mitigation used by banks when processing 'new loan' applications.[1403] At this stage lenders determine whether a commercial customer is eligible to receive loan finance, allowing 'full due diligence investigations to be undertaken.'[1404] As this section shows, there are a number of ways that the threat of a future risk can be abated before a loan is finalised. These techniques will now be discussed in further detail below.

1. External Expertise

The empirical data identify the use of 'external expertise' as an important pre-loan due diligence technique, and this is especially so with regards to identifying contamination issues on land. This section of the chapter looks at the lenders' relationship with environmental consultants, as well as the environmental risk assessment that consultants carry out for the banks.

1.1. Environmental Consultants

Consultancy services are 'multidisciplinary',[1405] and cover a number of professions.[1406] The main benefit of engaging external environmental consultancy services is that it allows a third party to help lenders evaluate and determine what can, more often than not, be highly complex situations.[1407] The main problem for the lender is whether it, or

[1403] Bryce (n 1187) 136. See also, Hood (n 71) 632.
[1404] ibid.
[1405] Case (n 48) 119.
[1406] Bryce (n 1187) 136.
[1407] Case (n 48) 118 – 119.

its borrower, should employ the consultancy service.[1408] Also, a further issue arises if the lender obtains 'key information' regarding its client's activities, as a result of the consultant's report; consequently, acquiring such information may result in lender liability as a 'knowingly permitter'.[1409]

Nevertheless, commissioned professionals can assist banks in numerous ways. First, a specialist environmental auditor will be able to evaluate a contaminated property's value, and also predict its future marketability.[1410] This is particularly useful in today's market, as it seems that some banks are holding contaminated land (almost as an asset management company) with the hope of selling on the land when redevelopment begins to regain its marketability. Secondly, environmental consultants are usually indemnified by their professional indemnity insurance (PII) policies, [1411] a form of third part liability insurance.[1412] This means that where the consultant has a PII policy, its own liability (e.g. for professional negligence) is covered in respect to others.[1413] However, the fact that PII provides adequate coverage for contamination issues is often 'a mistaken belief'.[1414] The limit of the indemnity can be for 'each and every claim',[1415] which means, 'that the limit is payable in respect of each claim.'[1416] However, this form of indemnity limit does not normally cover claims for environmental issues, like contamination.[1417] Instead, the indemnity limit is based on aggregate cover, i.e. 'the

[1408] Bryce (n 1187) 136. cf Hood (n 71) 632.
[1409] Hood (n 71) 632.
[1410] Jarvis and Fordham (n 51) 172.
[1411] Sykes, 'Environmental insurance solutions' (n 97) 30.
[1412] Construction Industry Council, 'Professional indemnity insurance for construction consultants' (*CIC website; Liability Briefing*, 2008) 1 <http://www.cic.org.uk/admin/resources/pi-insurance-for-construction-consultants.pdf> accessed 26 September 2014.
[1413] ibid, 1.
[1414] Sykes, 'Environmental insurance solutions' (n 97) 30.
[1415] Construction Industry Council (n 1412).
[1416] ibid.
[1417] ibid.

limit is only available once, however many claims are made, in the policy period.'[1418] With regards to PII and contaminated land, Sykes suggests:

> 'PII is available on a year-by-year basis; hence, there is no guaranteed long-term protection for the client. Moreover, if the consultant's PII is only available on an 'aggregate' basis, this means that the pot of available insurance money may be exhausted by other people's claims. Many environmental consultants carry no PII or significantly less than £2m cover.'[1419]

In the 1990s and 2000s, Part IIA of the EPA 1990 refined the existing investigation expertise surrounding the contaminated land market.[1420] During this time, bankers tracked the technical capacity for phase one investigation; they saw the phase one approach as an effective means of assessing their customers' sites for the presence of contaminant linkages.[1421] The instruction of external consultants became a crucial method for reducing the risks before some loans could be approved;[1422] and this is still true today. Below, Respondent 11 presents an opinion of when the use of external environmental consultation is most important in the banking due diligence process:

> *R_{11}: Externally commissioned environmental due diligence, I think, is most important where we believe there to be some form of contamination on the site, and we wish to get a feel for the scale of that contamination. And what*

[1418] ibid.
[1419] Sykes, 'Environmental insurance solutions' (n 97) 30.
[1420] Case (n 48) 118.
[1421] ibid.
[1422] Bryce (n 1187) 136.

> *we try to do, from the bank's perspective, is to assign an appropriate value to the site.*[1423]

As will be shown in the section on environmental risk assessment (below), the use of professional expertise from outside of the bank has become a necessity for the lenders' environmental risk management.[1424] However, this was not always the case; one interviewee said that, historically, most bankers' viewed external environmental consultants as a hindrance to the profitability of their business ventures.[1425] Now, the ability of the banks to sub-contract their work out to professionals is seen as an essential part of their pre- and post-loan due diligence. The use of external experts is mostly required to bridge the gaps in the bankers' knowledge of environmental risk assessment, which is a process that relies heavily upon scientific and technical analysis. When employing environmental consultants to carry out a pre-transaction risk evaluation, banks must ensure that they seek reliable, professional advice.[1426]

As environmental risk management continues to develop and expand in financial institutions, environmental expertise may be brought completely in-house in order to avoid the need to rely on third party advisers. Establishing a centre of environmental expertise within banks would reduce the inherent cost implications for lenders,[1427] as well as lowering premiums paid by borrowers, which have inevitably increased because of the need to exercise environmental due diligence. Actually, the empirical data show that further developing in-house expertise is already beginning to happen within one or

[1423] Interview with Respondent 11.
[1424] Hood (n 71) 632. See also, Case (n 48) 119.
[1425] Interview with Respondent 1.
[1426] See, *Urban Regeneration Agency and English Partnerships (Medway) Ltd v Mott Macdonald* [1999] EWCA Civ 1388. For a useful overview of this case, see, O'Keeffe (n 1394) 346.
[1427] Bryce (n 1187) 135. See also, Case (n 48) 118.

two of the most environmentally and socially conscious lenders.[1428] For the time being, however, it seems that the majority of banks in the UK will continue to choose to outsource their work to externally commissioned professionals. For instance, one of the UK's major clearing banks does not have an internal environmental manager, *per se*, and therefore chooses to use external consultants to conduct all of the necessary environmental due diligence for its corporate transactions. Outsourcing is preferred because environmental investigation is not a core task of a bank.

1.2. Environmental Risk Assessment[1429]

Environmental risk assessment (also known as auditing) is a process for determining the environmental risks on any given transaction.[1430] Such an assessment is 'an important component of any corporate initiative',[1431] and assists lenders when trying to identify prospective risks with a particular client, or a client's property, or both. In relation to contaminated land, the assessment of any real property that is going to be used as security against the loan is crucial in order to reduce the threat of suffering credit or security risk after the drawdown of the loan.[1432]

The practice of environmental risk assessment varies considerably.[1433] However, the empirical data show that bank lenders have adopted similar methods for assessing environmental risk. The majority of banks will attempt to feed as much data as possible

[1428] Refer to ch 5.
[1429] Bodson (n 1400) 475.
[1430] ibid.
[1431] J Lang, 'Legislative, Regulatory and Judicial Dilemmas in Environmental Auditing' (1999) 6(3) Eco-Mgmt Aud 101.
[1432] Case (n 48) 109.
[1433] N Gunningham and N Prest, 'Environmental Audit as a Regulatory Strategy: Prospects and Reform' (1993) 15 Syd L Rev 492, 494 – 497. In this article, Gunningham and Prest show that there are numerous audits that can be employed to assess environmental risks, i.e. 'operational audits', 'transactional audits', and 'environmental impact audits'.

into the risk assessment in order to come to an informed decision on whether to lend.[1434] Banks use external consultants to carry out environmental risk assessments, and provide a report (normally described as a 'site-guard' report) before the loan is approved. However, an environmental risk assessment may also be carried out before foreclosure, meaning that environmental risk assessment may also be regarded as a post-loan due diligence technique, which a lender can undertake on an individual site to assess any environmental risk that is caused by pollution. If, for instance, no contamination is found on the property, the bank can foreclose over the entirety of the mortgaged property in order to realise its securities. Below is interview data showing Respondent 1's experiences with the use of environmental risk assessments and external consultants:

> *I: So, are the direct and indirect risks processed in a different way, then?*
>
> *R_1: No, they are all processed through the same process, and the way we do it is through a land use questionnaire policy. Where we're going to lose money on this area is normally single operators, single sites; it is very rare that a big multi-national goes bust and nobody buys anything ... So, the way we deal with it is that whenever there's an evaluation done we get something called a [...] site guard report.*
>
> *I: So, this basically looks at all the different risks?*

[1434] O'Keeffe (n 1394) 347.

R_1: So, we've talked to Landmark many years ago, data wasn't really, wasn't really there, and then in 2005/2006 we worked with AIG to produce a desktop report, which was a site-guard report with a company called GroundSure, and what that does is that it gives us the historical data, so we know what's gone on before; but it also gives us the current data.

I: So, the current use?

R_1: Yeah, the current use. It gives us information on licences, permits, prosecutions, and whether there's petrol filling stations ... all sorts of ... and also the sensitivity; so, we get information on aquifers, abstractions, and this sort of thing. And that's all fed into our risk-ranking model. So, they'll have a risk; they'll put the data in; and information will come out of the risk-ranking model; and then depending upon the outcome, if its further assessment, then those cases come to me, and I look at those cases to see whether there is a risk. A desktop report that says fail, or further action, doesn't necessarily mean in practice a fail, or further action.

I: So, in the second stage, when it comes to you, you do more of an in-depth study, then?

R_1: Yes, but it is all based on credit risk. The way that we approach this is like we approach any other credit risk, and if we need specialist reports then we'll buy that in.

I: So, you get in external expertise to help, then?

> *R_1: To inform when we need to. So we do what we can in-house, and then if we need to, then we'll look to our panel, and get somebody in; but we only do that when we really see that there's a holistic risk. So you may have a risk, one that has failed and you are lending £500,000, and the valuation is £1.5 million; it could just have a Part, like a local authority Part B type permit, which would make the desktop report fail; so, for spraying a car, or something. You put that information together, and say that that's still acceptable. And it's my job to say whether those sites are acceptable, or not, as security.*[1435]

Respondent 1's data are very interesting, since they provide a practical account of how UK banks conduct their environmental due diligence. Throughout this excerpt the interview participant, an experienced lending risk manager, shows how banks are not totally dependent upon the knowledge of external consultants, and are often willing to assess the data themselves in order to come to an informed decision on whether or not to act. From Respondent 1's answer, it seems that banks will only employ outside professionals in a situation in which there is a particularly threatening site, which needs more expert eyes to view, and assess, the situation. Another interesting point made by Respondent 1 is the approach of the risk-ranking model for this particular bank, which is one based upon credit risk. This essentially means that environmental risk is processed through the same model of risk assessment that applies to all forms of credit risk. This accords to Weber, Fenchel and Scholz's empirical analysis of the integration of environmental risks into banks' credit risk management systems.[1436] From the

[1435] Interview with Respondent 1.
[1436] O Weber, M Fenchel and R Scholz, 'Empirical Analysis of the Integration of Environmental Risks into the Credit Risk Management Process of European Banks' (2008) 17 Bus Stat Env 149.

empirical findings of their study, Weber et al. state that, 'About 15 years ago, banks started to integrate environmental risks into their credit risk management procedures.'[1437] The fact that some banks have chosen to incorporate environmental risk management into their credit risk setting is unsurprising. Banks have been assessing credit risk for a very long time, and are therefore comfortable with recognising any events that may lead to credit risk on a loan. It seems only sensible that they should try to develop a system that offers the same degree of comfort with regards to their environmental risk management.

1.2.1. Phase I Risk Assessment

Although risk assessments differ between lenders, banks tend to implement a similar initial 'scoping exercise' at the very beginning of their risk assessment process.[1438] Some call this a 'Phase I Risk Assessment'; on the other hand, others will introduce a lighter-touch 'desktop' assessment before they begin the Phase 1 Assessment process.[1439] During this preliminary stage, a brief desktop study will be performed in order to analyse the potential risks that may lie with prospective clients and their properties.[1440] O'Donovan states that, 'A preliminary environmental audit does not always reveal the full extent of pollution or contamination, but it can alert the lender to the risk of environmental damage.'[1441] Respondent 3 talked about the preliminary risk assessment in interview.

[1437] ibid.
[1438] Bellis and Decleve (n 1398) 391.
[1439] Gunningham and Prest (n 1433) 494.
[1440] ibid. See also, O'Keeffe (n 1394) 347.
[1441] O'Donovan (n 63) 625. See also, Gunningham and Prest (n 1433) 526.

> *R_3: So, they* [the bank], *internally, have, uhm, I think there's only one guy I know, but they put together a process where they had established a panel of consultants and every time that someone applied for a loan, which involved securing the loan against property, they would have to go and pay for a consultant to come in to do a phase 1 survey, and that formed part of the loan application documentation, and that was fed into the credit decision making, the credit committee, or whatever they had there that would approve the loan, and that's how they did it.*
>
> *I: And the Phase 1 is more or less a desktop study, then?*
>
> *R_3: Yeah, it's essentially a desktop, you know, it's common to do a site visit as well, but, essentially, it's a desktop where, you know, and I use to do these things, you'd get a report from a company called Landmark Enviro-check, and they'd ... they're, basically, a data aggregator, and they buy data from the EA, and from various different sources, and they give you these maps with, sort of, red flags, and you see immediately if a site is more likely to have a problem or not. They have records of pollution incidents.*[1442]

Phase I Risk Assessment is, thus, a preliminary inquiry (a desktop study) of a client and the client's property. While there is no universal method for implementing a Phase I audit,[1443] it usually includes, *inter alia*:

[1442] Interview with Respondent 3. Brackets added.
[1443] O'Keeffe and Boileau (n 1274) 348.

- A review of a client's background in order to determine whether they have a history of environmental damage;[1444]

- An appraisal of the relevant environmental laws and regulations that may impede a client's creditworthiness;[1445]

- An examination of a client's site – this may include an analysis of Ordinance Survey Maps/Google Earth, a site walkover, local authority registers etc.;[1446] and finally

- An environmental audit of a site's marketability etc.[1447]

In relation to contaminated land, a Phase 1 Risk Assessment aims to check a site's historical and current use in order to gauge whether the land has been, or is susceptible to be, identified as 'contaminated land' by a local authority under section 78B of the EPA 1990.[1448] During this inspection, the site will be scoped for contaminant linkages, and the threat that the land may pose to any relevant receptors that may be situated in close proximity to the property. The Phase 1 audit can also look at a prospective client's history. If a client has created environmental damage in the past, the bank may then need to request more stringent terms and conditions of the loan agreement[1449] before the borrower is deemed eligible to receive loan funding.

[1444] O'Keeffe (n 1394) 347.
[1445] ibid.
[1446] ibid.
[1447] ibid.
[1448] EPA 1990, s 78B.
[1449] infra, pg 271.

1.2.2. Phase II Risk Assessment

If, after the Phase 1 study has been completed, it is evident that a risk is still reasonably foreseeable prior to the completion of the transaction the bank may walk away if there is not a lot of value in the loan. However, if the loan is valuable, specialist consultants should be commissioned in order to conduct a Phase 2 Risk Assessment for the bank.[1450] A Phase 2 Risk Assessment concerns a more intrusive site investigation.[1451] After describing the Phase 1 Risk Assessment in some detail, Respondent 3 then went on to outline the next stage of the environmental risk management process:

> *R_3: A Phase 1 will say something, like, "There has been some pollution. They've had a fuel tank that's been leaking. The geology is such that it would permit any fuel in the ground that it would allow it to permeate through the ground, you know, the aquifer ... whatever! There's a sensitive receptor because somebody is using the ground water aquifer for drinking water supply." So, putting these three things together, you know, that justifies an actual intrusive investigation where you would do soil sampling, or you would do ground water sampling, and actually test it for hydrocarbons, or whatever. So that's the way it works.*
>
> *I: So, then you can either reject the loan, or move on?*

[1450] O'Keeffe (n 1394) 348.
[1451] Case (n 48) 121.

> *R_3: Yeah, you know, typically, the bank would, if there's a ground water situation, the bank would say, "Look, no way, it's too complicated", and the client would have to work very hard to go back from that point.*[1452]

In the case of assessing whether a property may be determined as contaminated land, the Phase 2 Risk Assessment may be made up of *inter alia*:

- A site walkover;[1453]
- Boring holes or digging trenches;[1454]
- Geo-physical ground analysis;[1455] and
- Taking samples in order to assess the soil and groundwater for the presence of contaminants etc.[1456]

While costly, complex, and lengthy,[1457] this process is essential for land that is affected by pollution, as it may carry more liability than profit. However, the necessary conduct of a Phase II Risk Assessment can directly impact a transaction, as O'Keeffe notes:

> 'If a Phase II audit is required this could have a considerable impact on the transaction as it can take several weeks to complete. In some cases it is not possible to wait for this to be completed, and agreement needs to be reached

[1452] Interview with Respondent 3.
[1453] O'Keeffe (n 1394) 348.
[1454] ibid.
[1455] ibid.
[1456] ibid.
[1457] Case (n 48) 121.

on who pays for the investigations and who takes the risk after completion.'

[1458]

If the Phase 2 Risk Assessment shows a high degree of risk, the bank may request that the customer take remedial action before the loan is provided to them: making clean-up an express agreement contingent to the receipt of the loan can enforce this type of action. Or again, if the loan is not that valuable, the bank still has the option of walking away.

1.2.3. Phase III Risk Assessment

This phase of risk assessment is more for borrowers, as it relates to the actions that should be taken to avert risks. Borrowers should create a Phase 3 Risk Assessment protocol to reduce the risks that may be created by their operations. For example, if a borrower is found to be an appropriate person to bear the responsibility for remediation under Part IIA, they should, in accordance with the concept of 'Best Practicable Technique' (BPT), create a remediation plan for clean-up. Such endeavors can be aided by the advice and support of the enforcing authority and/or appropriate Agency overseeing the remediation. Prudent borrowers that have a plan for remediation are less likely to become insolvent because of high remediation costs, which may mean that they are subsequently less likely to default upon their loan repayments and create risks for the bank.

[1458] O'Keeffe and Boileau (n 1274) 348.

1.2.4. Environmental Risk Assessment: a necessary hindrance for lenders?

While risk assessment is important, it seems that it is not conclusive to the banks' decision-making. This is because environmental risks are not viewed as a major threat to financial institutions; and, even though an environmental risk may be present after assessing a site or client, some banks may still be willing to provide that customer with funding. This is clear from the answer that Respondent 1 gave when asked this question during their interview:

> *R_1: Yes, because if you're a customer… our job is to lend money, and we do like lending money, we are actually quite good at lending money. So, we want to lend money, so you can't just say "No" just because a desktop has failed. Depending upon where you get them from, anything up to 50% of them fail. So, if you are saying that 50% of our customers can't give that site a security because of environmental risk, then you're not going to last too long because in reality that's not… that's not what practice tells us.*[1459]

Respondent 1 also suggested that, while the risk assessment process is necessary, weak enforcement of the various regimes concerning land and water pollution means that banks rarely fear liability:

> *R_1: We do environmental impairment liability insurance, typically, where there's an issue on a site, like you have an old, unlicensed landfill. We did one in [xxx] not so long ago, couple of weeks ago! The history was terrible,*

[1459] Interview with Respondent 1.

but there was no redevelopment going on and you could phase 1 – phase 2 – dig holes until the cows come home, and it would tell you that it was contaminated. But, in practice, is the regulator going to serve an enforcement notice on that site? Well do you know how many enforcement notices have been served in the last data that the EA produce in 2007?

I: Determinations were very low!

R1: Was it 10? I think in the whole of the UK? So, then, you know, rightly or wrongly, we look at the practical implementation of it, so …

I: It's not much of a risk at all, really, is it!

R1: No![1460]

Since lenders are in business to make money, it is difficult for them to simply reject loan applications because of prospective environmental issues. As the respondent's excerpt (above) suggests, 'anything up to 50% of them [site-guard reports] fail'. Thus, even the most prudent and reasonable banks would agree that it is not good business practice to turn down fifty per cent of your commercial lending opportunities because of, what is considered in the financial world, an insignificant risk that is highly unlikely to materialise. When asked, the bankers suggested that very few of their commercial borrowers fall into insolvency because of environmental issues, and, in some cases, they will provide loan finance with the hope that nothing will happen in the future. Such an attitude represents, what may be described as 'a risk-based approach' to

[1460] ibid.

environmental risk management, which is typical of the method used by the majority of lenders situated in Europe. If a bank rejects a loan to a large commercial customer, it is highly likely that there would be many other banks that would be willing to take on the risk of lending to that client. In the somewhat ruthless world of banking, opportunities cannot be easily foregone, and this is especially so with regards to the rejection of loans relating to non-financial risks. Therefore, even though environmental risk assessment is a useful weapon in the bankers' arsenal of pre-loan due diligence techniques, in some circumstances it is still perceived by the bankers as a process that can hinder the ordinary course of lending to important commercial clients.

2. The Loan Agreement and Security Documentation

The interview data suggest that a popular method for reducing environmental risks is to insert conditions precedent into the loan and security documentation. However, the data also portray that banks do not create specialised loans that offer 'packaged solutions' for environmental problems.

> *I: Great! And do you tailor make loans with environmental clauses in them?*
>
> *R_5: I haven't come across any loan where a company will come specifically to us and say, "I need $100 million to clean-up a site."*[1461]

Nonetheless, it is evident that conditions precedent are now being widely used within the banks' loan and security documentation in order to protect the lenders from any environmental issues that may arise during the course of lending. Respondent 11 also

[1461] Interview with Respondent 5.

stated some of the ways in which banks use the loan documentation to make the lending process safer and more manageable:

> *I: Are there any loans which have been tailor made to deal with environmental issues?*
>
> *R_{11}: Okay, so not as products that we will market, specifically. We don't have a packaged solution, but we will, for example, where we feel that it is beneficial to protect the bank's position, we might engage in a phased draw down; so, uhm, loan amounts, which are available at set milestones, which might a line, for example, with a remediation plan; or, more likely, with general steps within the construction process, which may include some remediation. We may apply specific loan covenants, conditions to the loan, where we require from the borrower, either, single point in time actions, such as: completion of a successful remediation plan; or, indeed, full remediation; or also just monitoring considerations – update reports on compliance with legislation and regulation, and discussion with regulatory bodies. I think it's more of a case of tweaking the way that we apply a product.*[1462]

Conditions precedent are important. Their main function is to protect the bank from the drawdown of funding if a particular condition is not met. The default triggers that are commonly used by banks to reduce environmental risks comprise of:

[1462] Interview with Respondent 11.

Loan Covenants – covenants are quite useful because their application can compel a bank's client to satisfy specified conditions relating to environmental protection.[1463] A failure to show compliance with the covenants will result in a default under the loan agreement. Standard covenants that are currently being used within the loan and security documents includes, amongst other things:

- To act in accordance with all necessary laws and regulations;[1464]

- Prohibition against certain environmentally damaging activities, and the use of particular equipment, that is likely to create environmental risk or exempt the site's insurance cover;[1465]

- To notify the bank in the situation where an event (an unlawful spillage or discharge, authority's inspection and determinations, prosecution etc.) has occurred during business operations, which may result in risk;[1466]

- If environmental damage does occur, the borrower must conduct the appropriate level of remediation following the Best Practicable Technique;[1467]

- If found liable, the bank is thereby absolved from any liability;[1468]

- To keep the property insured.

[1463] Bodson (n 1400) 477.
[1464] ibid, 478.
[1465] ibid.
[1466] ibid.
[1467] ibid.
[1468] ibid.

Environmental loan covenants can be productive because they can make borrowers carry out specific activities or comply with specific environmental regulation.[1469] They can also restrict the activities of borrowers by preventing them from pursuing certain environmentally harmful conduct that may be in violation of specific environmental regulations, and, as a consequence, affect their ability to operate effectively.[1470]

Representations and Warranties (R & Ws) – R & Ws are clauses that seek to ensure both the borrower's ability to repay the loan, and the borrower's express agreement that the bank has been provided with all of the necessary information requested prior to the loan being granted. R & Ws are highly useful for banks' pre-loan environmental risk management, since they can draw out necessary information, such as:

- Whether a site is subject to environmental issues because of its condition and the existence and validity of permits;[1471]

- Whether a client is of a *bona fide* character and eligible to receive funding;[1472] and

- For contaminated and suspect land, specifically, the bank can draft an R & W clause into the loan agreement that requires the removal of a significant, or a significant possibility of, harm that is created by a contaminant linkage which

[1469] Hood (n 71) 631.
[1470] ibid.
[1471] Bodson, (n 1400) 478.
[1472] ibid.

is present in, on or under the land, or within a controlled water system, before the loan is approved.

It is important to make it clear that R & Ws, in a loan agreement, are not a pre-contract device, but are repeated during the life time of the loan.

Indemnity Clauses – the loan agreement can also be used to indemnify the lender from any environmental liability [1473] (i.e. criminal, civil, or clean-up) that may be reasonably incurred after the loan has been approved and provided to the borrower. Such a clause will often expressly state that, simply because of the provision of loan finance, the lender does not hold a 'controlling relationship' within the borrower's commercial enterprise, and that any monitoring and reporting that does takes place is simply as a part of the lender's ordinary post-loan due diligence.

B. Post-loan Due Diligence

The chapter on historic land contamination showed that the lenders' control over their borrowers must be kept to a minimum at all times in order to avoid the materialisation of a *Fleet Factors* type scenario of lender liability for environmental damage.[1474] Post-loan due diligence may be used to avoid this type of risk from occurring. This stage of the due diligence process relates to the risk assessment methods that are invoked after the loan has been approved. Upon approval of the loan both parties are thereby contractually bound under the terms of the loan documentation. While this phase of environmental risk management may not be as important as pre-loan due diligence, it

[1473] ibid.
[1474] Refer to ch 2.

is nevertheless a necessary feature when lending to commercial customers that operate in vulnerable sectors. Post-loan due diligence involves the stage of environmental risk management where banks seek to monitor, report on, and audit their clients' compliance within the terms of their loan agreement. This is done in order to maintain the conditions that existed when the contract was first entered into; it also gives the lender and borrower a chance to reduce the likelihood and severity of any liabilities and risks that may develop after the loan has come into effect.

Post-loan due diligence is not only used to maintain customers' creditworthiness, it is also extremely useful in the event of insolvency. One insolvent borrower will ultimately impact upon a bank's ability to make a viable profit upon their transactions. Thus, post-loan due diligence is also being used to safeguard lenders from acquiring liability as a mortgagee in possession, when exercising security rights in insolvency.

1. The Control Dilemma

The control dilemma is an issue that banks have tried to resolve for many years.

> 'At this point the lender may be inclined to exert even more control over the borrower's day-to-day operations. However, that action places the lender on the horns of a dilemma: the more control it exerts, the more potential responsibility it assumes for environmental countermeasures.'[1475]

The main question for the bank to ask upon any transaction that it is a part of is: How much control can I have over the client before I adopt my client's risks and liabilities?

[1475] Fordyce, Kofman and Tay (n 80) 21.

At the introduction of the part on the legal basis for environmental liability and risk, it was shown that the American lenders' experiences with CERCLA caused an uncertain relationship to emerge between banks and their borrowers. This resulted in a grey area, which was described as the 'CERCLA Dilemma'.[1476] During the time between CERCLA, and its later revisions under Superfund, lenders did not fully understand their relationship with their borrowers.[1477] How much advice they should give? What types of activities could they undertake?[1478]

While not as prominent as the American banks' experiences of lender liability and risk for environmental issues, financial institutions in the UK must still be cautious about the degree of control that they exercise over their borrowers. Due to the lack of case law concerning lender liability for environmental damage, there remains uncertainty as to the exact amount of control that a lender can have over its borrowers before it becomes exposed to legal culpability. Nevertheless, for a court determining a lender's position within proceedings, it is conceptually possible to establish a relationship of control, and transfer liability for either causing or knowingly permitting environmental harm onto a bank.[1479] And the environmental risk managers in the banks are aware of the dangers of having too much control over their borrowers' activities. For example, Respondent 9 suggested that lender liability could be incurred if the bank places one of its employees onto the board of directors of one of their borrowers:[1480]

[1476] A Hoffman, D Seaman and R Jeffrey, 'A Pragmatic Solution To A Complex Dilemma: A Fundamental Approach To Resolving The Conflict Between CERCLA And The Bankruptcy Code' (1996) 4 Am Bankr Inst L Rev 243.
[1477] ibid.
[1478] ibid.
[1479] ibid.
[1480] See, *a Company, ex p Copp* (n 948) 13.

> *R9: They could be, I mean, sure if a company goes bankrupt, then they will lose their money. They don't have any lender liability beyond that, unless, they are silly enough to put someone on the board of the company with executive responsibility. That's the only way I think ... I understand ... that a bank could become liable; if they have one of their employees, as an executive director, on the board of the company that they have invested in, which is an executive responsibility.*[1481]

Control also becomes an issue when trying to determine the question of ownership of contaminated and suspect land. As noted earlier,[1482] 'ownership' is an umbrella term covering being either an owner or occupier of property. Fortunately, the definition of owner in the EPA 1990 protects lenders (to some extent). As outlined several times before, under section 78A(9), an owner of contaminated land is a person, other than a mortgagee in possession, who is entitled to the rack rent of the land.[1483] An act of foreclosure will constitute a position of ownership. Therefore, the safest way for lenders to avoid Part IIA liability as an appropriate person is to not take possession of any aspect of the land subject to contaminative liabilities, even if this means that the bank makes a substantial financial loss in the process. Unfortunately, the lack of judicial precedent on this topic means that a great deal of ambiguity surrounds the lender - borrower relationship in the UK. There are, however, a number of questions that must be asked in relation to the idea of control:

[1481] Interview with Respondent 9.
[1482] Refer to ch 2.
[1483] EPA 1990, s 78A(9).

- What constitutes a ‘controlling relationship’?

- What types of lending activities are most likely to place a bank in a position of control?

- How can lenders reduce the amount of control that they have over their borrowers so that they are no longer at risk?

With regards to the final question, it seems that there are a variety of control devices that lenders can, and do, use in order to limit the severity of their risk exposure during their commercial loan financing. The most popular examples include:

- Monitoring, reporting and auditing;

- Drafting conditions precedent into the loan agreement and security documentation;

- Environmental insurance;

- Financial assurances; and

- The use of insolvency practitioners.

The section below outlines the different methods that are used in the banks’ post-loan due diligence for reducing environmental risk. As corporate insolvency risk has been

outlined in some depth in Chapter 4,[1484] the use of insolvency practitioners as a form of due diligence is not outlined in this section of the chapter.

1.1. Monitoring, Reporting and Auditing

The post-loan due diligence process may allow lenders to monitor, report on, and audit their customers' progress. Lenders will often make it a condition of the loan for their borrowers to provide progress reports after the loan is granted; this way the bank's risk teams will continue to evaluate whether a particular customer is sustaining the necessary state of eligibility. While this is not true for all banks, normally this process occurs every six months for a new client, and annually for their existing customers with a good track record.

There is, however, a problem with this type of due diligence method. Monitoring, reporting, and auditing are the perfect ingredients for creating a controlling relationship between a lender and its borrowers. A bank that has too much control over a borrower that pollutes the mortgaged property may also incur Class A liability as a person that knowingly permitted the contamination to occur.[1485] In response to this issue, Jarvis and Fordham stipulate that the ability for a bank to monitor its customers' compliance is a necessary requisite that cannot be removed from bank lending.[1486] With regards to the element of control, they suggest that lenders' degree of control may be limited, 'by making the borrower pay for, and facilitate, such investigations as a condition for obtaining the loan.'[1487] By shifting the burden onto borrowers, lenders can essentially

[1484] Refer to ch 4.
[1485] Refer to ch 2.
[1486] Jarvis and Fordham (n 51) 171.
[1487] ibid.

by-pass liability that may otherwise be owed by the bank to a person that is affected by environmental issues which have been created from the suspect land.

1.2. The Loan Agreement and Security Documentation

Conditions precedent (as described above) can be used to reduce the amount of control that exists between a lender and a borrower. Consequently, it is now standard practice for lenders to insert conditions into the loan and security documentation in order to reduce the threat posed to them by environmental risks.[1488] This form of due diligence has already been discussed in the section on pre-loan due diligence methods.[1489] Post-loan the loan document must demand compliance so that it keeps the borrower in check with the necessary terms and conditions of the loan agreement, and any associated environmental regulation. It must also show that the post-loan monitoring and reporting is merely a part of the bank's normal underwriting activities, and that the bank has no actual control over how its borrower carries out its business operations.

1.3. Environmental Insurance

Insurance may be used to protect lenders from environmental liabilities.[1490] However, it was shown earlier in the chapter that, in relation to environmental issues, the use of general insurance policies may not be the most reliable remedy.[1491] In order to be protected lenders will have to require that their borrowers obtain an environmental liability insurance policy negotiated, if necessary, to cover the requisite liabilities.

[1488] ibid.
[1489] Refer to pg 255.
[1490] O'Donovan (n 63) 625. See also, Sykes, 'Environmental insurance solutions' (n 97) 27.
[1491] Refer to pg 255-259.

Environmental insurance is necessary because, like PII and the aggregate indemnity cover for environmental claims, 'general public liability policies… often exclude environmental liability.'[1492] In *Bartoline Ltd v Royal Sun & Alliance Insurance plc* [2006] 1 All ER (Comm) 1043[1493] the claimant carried on a manufacturing plant. Following a fire at the plant, polluting matter entered into an adjacent watercourse causing pollution. The Environment Agency carried out emergency works under section 161A of the Water Resources Act 1991,[1494] later claiming for the recovery of costs which amounted to £750,000 under section 161(3) of the 1991 Act.[1495] The claimant sought to claim for the losses under the public liability section of its insurance policy. Hegarty J ruled that the losses incurred did not 'fall within the scope of the relevant indemnity.'[1496] Considering the decision in *Bartoline*, it is important that the appropriate insurance policy is purchased.

With regards to the use of environmental insurance, Respondent 1 said:

> *I: What about insurance, then? Would you request for your clients to get the necessary insurance?*
>
> *R_1: Yes … Maybe, maybe! I mean insurance has been an interesting one. We've looked at insurance many times. We've even developed a product as a bespoke product for our clients; that was a lot of work. The problem with insurance is that, when you wanted insurance, originally, there were only two or three insurance providers. If you had any sort of issue, they wouldn't*

[1492] ibid.
[1493] *Bartoline Ltd v Royal Sun & Alliance Insurance plc* [2006] 1 All ER (Comm) 1043.
[1494] Water Resources Act 1991, s 161A.
[1495] ibid, s 161(3).
[1496] *Bartoline* (n 1493), para 110 (Hegarty J).

insure: "Okay, so can you insure this?" ... "Oh, No!" ... Or, "Yes, that'll cost £200,000 a year!" So it was an option, but only for those with the deepest pockets. So, then we tried to have a more site specific policy, which we developed with Marsh. We didn't make it mandatory because we try to keep costs away for our customers. If I'm honest, we had a site specific policy – quite low cost – but it wasn't mandatory, it was up to the customer to take it out. So it died there! Now you can, actually, get insurance quite easily and quite quickly and quite cost effective. So I've done quite a few deals this year where we've mandated insurance because it has actually been cheaper than actually doing the due diligence!

Environmental risks may affect many stakeholders in corporate transactions. Environmental insurance needs to be considered more thoroughly by lenders as a means of protecting themselves from environmental risks. For example, if a borrower causes pollution, a claim can be made on the environmental insurance policy to cover any associated remediation costs. The use of insurance acts to decrease the likelihood of a borrower's insolvency and increases the prospects of the full repayment of the loan, thereby reducing instances of credit risk. The data show that environmental insurance has become a more practicable tool in recent years as premiums have fallen:

I: Is insurance difficult to obtain?

R_2: No, I think that the market ... there's a lot of insurance companies that have branched out to deal with environmental insurance, and I think there's quite a lot available. Premiums have come down from what they used to be and they're covering all sorts of things now, so third parties. I mean ... uhm

> *... in terms of the properties I know, I think some banks just undertaken environmental assessments on more industrial companies and they'll look at categorization. If it's retail they probably won't do anything; if it's commercial they'll think, "Do we need it or not?" Based on that we're taking, uhm, on that process.*[1497]

In a paper written on environmental insurance solutions for reducing environmental risk in commercial transactions involving contaminated and suspect land, Sykes states:

> 'Environmental and financial risks for purchasers, vendors and lenders have jeopardised innumerable property deals over recent years. Buyers are concerned about acquiring environmental liabilities that have not yet been qualified. Sellers are anxious about the retention of liability after disposal of a site. Lenders worry about the credit risk presented by borrowers and about the value of their security.'[1498]

As well as environmental due diligence in banks, CERCLA and Part IIA have also acted as the primary drivers for the growth of the environmental insurance market.[1499] In his paper, Sykes presents an argument for the use of environmental insurance as a solution for analysing risk and instilling confidence into the buyers, sellers, and lenders of contaminated and suspect land. Since Sykes' article was published in 1999 much has happened in relation to this field, and the UK's financial and insurance markets have incorporated environmental insurance policies into their ambit. Surprisingly, some of

[1497] Interview with Respondent 2.
[1498] Sykes, 'Environmental insurance solutions' (n 97) 27.
[1499] ibid.

the empirical data suggest that financial institutions are not particularly *au fait* with environmental insurance policies. The data also show that banks are often too lenient when it comes to their customers purchasing the necessary environmental insurance cover. In relation to environmental risks, this may turn out to be an Achilles' heel for banks. Respondent 9 highlights a number of problems with the banks' current attitude towards their customers possessing the necessary insurance to cover environmental issues that may arise during the course of the loan:

> *R_9: Now I do think that the banks are probably living a little bit in the past, personal opinion only, because the banks just want pieces of paper. They want you to say, "It is a good loan because I know my business", or, "My business has got a good track record". Fine, and you have paper work to show that. You have accounts and you have had your accounts properly audited as well. You then put up your business plan, so that can be audited by the usual guys and then they put up things like, "Are you adequately insured?" And you go, "Yes, we have a property policy that covers our property and we have a general liability policy for that risk and, of course, we have employees' liability insurance; that we have to have etc." Then the bank goes, "Oh fine, we'll invest!" Mainly it used to be transactions, transactions insurance; but an environmental insurance policy is going to offer cover for future issues arising out of past actions. So, if the land has been contaminated by past activities and that contamination could become a problem in the future, unexpectedly, then that's what the policy should cover… So the point that I am trying to get at here is that I don't think the banks are doing enough because they are investing in companies, and if*

> *you have a major fire and that fire of you chemical company pollutes all of the land, either the chemical company has got insurance for their property and can rebuild, or they don't have any insurance to clean it up; and if they can't afford to clean it up, then the investment goes down the toilet.*[1500]

In disagreement with Respondent 9's reasoning, Respondent 3 suggested that banks do tend to have a good understanding of environmental insurance, and the reason why environmental insurance has not been used as a means of reducing environmental risk is not because the banks have not endorsed it, but, rather, because people have not developed enough confidence to use it effectively, since they are worried that the cover is insufficiently comprehensive:

> *R_3: The other common one is insurance, which is a bit of a, uh, well I think they've had a bit of a rough ride here, and it probably hasn't been as successful as it should have been. I mean it is a sort of an attractive idea. In principle, you can use insurance to get everybody comfortable with land transactions. The buyer will say, "Dear seller, there's obviously a big problem here, please provide the appropriate insurance in my favour, and I'll go ahead with the deal." That's, typically, how it is used; they'll either chip some money off the price to cover that, or the seller will give benefit of that to the purchaser to get through. People are a little bit nervous with insurance because they are always worried that they are going to pay out. There are lots of ways that you can weasel out of actually paying, so, I think my impression's been, that people on transactions are a little bit worried*

[1500] Interview with Respondent 9.

about the utility of insurance, and whether, or not, it is actually going to do what people think it's going to do. So, you tend to get a 10 year coverage, you know, it's actually relatively cheap, around £25,000-50,000 will normally get you 5 or 10 years coverage up to a certain amount. The problem with insurance is that there's an excess sort of a thing, you know, so, if the clean-up bill is up to £100,000, anything under that and the insurance won't pay that first £ 100,000. It has to go over a certain amount before you start getting money and there's lots of clauses, you know, and it doesn't cover this, or it doesn't cover that, and it only applies in certain situations. So, people see all of that, and I think that they are, sort of, reluctant to go down that road, you know, because I don't think that people are confident that it's going to give them the protection that they think it will.[1501]

In contrast with the use of specific environmental insurance in the UK, the data show that insurance tends to be more readily used by banks and companies based in America:

I: Do you ask your clients to get specific insurance, environmental insurance?

R_5: Yes, we do look at this as a part of the credit risk review, which includes an insurance policy and all of the liabilities and how those can affect their abilities. They [the credit risk review] are not focusing on environment, they will look at other things, all sorts of mishaps that may have happened

[1501] Interview with Respondent 3.

in the past. If you have a listed company, a lot of these things have to be disclosed uh in the financial statements, so it's easier to look at. When you have companies that are not listed, you really have to do a lot more research.[1502]

And,

I: And, what about environmental insurance? Do you use insurance much?

R_6: We use insurance quite often, it used to be mandatory for anybody that had a gas station operation, because normally all the money the individual has is invested in the gas station; so they will have to have their tanks insured in case they leaked.[1503]

1.4. Financial Assurances

Financial assurances can be a useful post-loan due diligence technique for remedying the credit and security risks caused by borrowers' inability to pay for both liability for clean-up costs and the loan; it is especially beneficial for small companies with large liabilities.

Some laws require, as an indicator of competency, a person's capability of providing financial assurance in order to remedy any damage that is caused. Take, for example, regulation 13 of the Environmental Permitting (England and Wales) Regulations 2010

[1502] Interview with Respondent 5.
[1503] Interview with Respondent 6.

(as amended) which states that the regulator may, before providing a person with an environmental permit made pursuant to the Regulations, consider the applicant's financial competence as an indicator of a permit holder's eligibility to receive a licence to operate.[1504] A lender may, by an express condition of the loan, request a borrower to create a fund (i.e. a trust fund or an ESCROW account) that may be used as a source of revenue for remediation action in the case where environmental harm has materialised.[1505] Finally, it is worth noting that *Hillridge*-type scenarios are easily cured by careful drafting, and should therefore be regarded as a low risk for prudent lenders.

III. Conclusion

This chapter has provided a practical and up-to-date insight into the current environmental due diligence techniques that are being employed by lenders based in the UK. It has been shown that, while all banks may have slight differences in their due diligence processes (as one would suspect), the majority of banks mitigate for environmental risks in a similar way; and the easiest way to describe this process of risk reduction is to break it down into two primary stages: pre- and post-loan due diligence.

The next chapter (Chapter 7) presents the findings that relate to the various drivers for environmental due diligence in banking.

[1504] Environmental Permitting (England and Wales) Regulations 2010, SI 2010/675, reg 13.
[1505] Companies Act (CA) 2006, ss 1012-1023. See also, *Hillridge* (n 1201).

Chapter 7:

The Drivers for, and Continued Growth of,

Environmental Due Diligence in Banks

Having a system in place that manages environmental risks is acquiring greater importance amongst financial institutions. The use of such a system creates a degree of safety for banks when entering into any commercial transaction (e.g. lending and debt collecting, investment and divestment, mergers and acquisitions and initial public offerings, purchasing and selling property, and asset management) that may be subject to inherent environmental issues. Following on from Chapter 6, which presented the different types of environmental due diligence, this chapter outlines the drivers for, and continued growth of, environmental due diligence in banks. It is therefore relevant to the overarching research question and sub-question 3 (i.e. 'What are the main drivers for the use of environmental risk management in banks?'), because it shows what is presently driving lenders' conduct of environmental due diligence, considering the fact that the environmental legal basis has been shown to present no real direct liability risk. The chapter also offers a glimpse into the future growth and direction of environmental due diligence in lending institutions. This chapter is thus different to Chapter 5, which looked at the different environmental risks, and the lenders' ranking of the threat posed by the risks. It is also important to emphasise that more interview data are used in this chapter than anywhere else in the thesis. Consequently, this chapter is essential for displaying the thesis' original contribution to the knowledge of the research field. The unique data from the banking respondents fill the knowledge gaps that reside in the research area. The categories that were used to code the data are outlined throughout.

I. The Drivers for Environmental Due Diligence

Although there are a number of drivers that may help to explain the continued growth of environmental due diligence, the research data collected show that the primary drivers for the conduct of environmental due diligence can be summarised as follows:

- The Need to Reduce the Threat of Legal Exposures;
- Market Volatility;
- Corporate Social Responsibility and Green Supply Chain Management;
- Credit and Security Loss, and Clients' Eligibility;
- Credit Risk Management Frameworks for Managing and Limiting Environmental and Social Risks in Project Finance Transactions; and
- Reputational Risk.

The list above derives from the empirical data. In answering sub-question 3, i.e. 'What are the main drivers for the use of environmental risk management in banks?' this section presents an outlined view of these six drivers, evaluating the primary driver at this present time of writing. All data that were relevant to the section below were coded into the yellow coding category, and underlined accordingly (see Chapter 1). The purpose of this chapter is not only to isolate the primary driver for the lenders' use of

environmental risk management, but also to demonstrate how the different drivers have contributed to influencing this form of due diligence.

A. The Need to Reduce the Threat of Legal Exposures

While the liability fear caused by the enactment of specific environmental laws a little over ten years ago initially drove the implementation of due diligence, it may now be argued that the threat of legal exposure is no longer the primary driving force for lenders today. However, even though the threat of this driver has decreased significantly, because the banks have learnt to adapt to compliance issues over the years, this is not to say that legal compliance risk no longer continues to drive environmental risk management in banks, as Respondent 12 pointed out:

> *R_{12}: Really the amount of environmental law, which is, potentially, therefore, an exposure to a financial institution, is just increasing by the day and by the month.*[1506]

The threat of environmental liability and risks for land and water pollution has posed increased legal exposure in many contractual relationships (e.g. landlord and tenant, seller and purchaser, and lender and borrower). It cannot be disputed that the supplementary pressure placed upon parties to such contracts has had the effect of heightening the need to develop techniques that aim to reasonably assess, and alleviate, any environmental issues that are likely to occur within such transactions. Despite the increased strain, parties to contracts that are likely to suffer from contamination

[1506] Interview with Respondent 12.

liabilities under Part IIA have learnt to adapt to the threats that were created by the implementation, and use, of specific due diligence methods. This means that, nowadays, in the world of commercial lending, even the most polluting industries can still receive loan financing.

> *R_{10}: I don't think we restrict our lending to any particular sectors. There are some sectors that we will be really restricted on them and don't like to lend so much.*[1507]

It has already been established that Part IIA's enforcement has led to the emergence of environmental due diligence in bank lending. When Part IIA was eventually brought into force in 2000, lenders based in Britain were concerned that they would be made liable for their borrowers' environmental issues. This type of environmental liability had only previously been witnessed under the CERCLA regime in America during the 1980s, as Respondent 1 stated:

> *I: So, what was the main driver, do you think, in 1997/1998 before … uhm … was there a lot of environmental risk management in that time?*
>
> *R_1: Before CERCLA came along, and before Part IIA – no, none, nothing at all.*
>
> *I: So it was, kinda, one of the drivers for this new way of thinking?*

[1507] Interview with Respondent 10.

R_1: It was a new risk, nobody knew what it was, how to assess it. But, in terms of ... I mean ... So what we've done is we've taken an issue that was new, and we've made it business as usual; so we integrated it into our credit assessment.[1508]

When enacted, Part IIA was viewed as a new legal risk. As Respondent 1 suggested, upon its inception, Part IIA created a fear of environmental liability which spread throughout the UK's financial market. Part IIA's enactment was significant because, for the first time in Britain's history, a regime was created specifically for contaminated land clean-up. During that time, parties involved in the contaminated land market were uncertain as to the likelihood and severity of liability that Part IIA would create.[1509] After the lender liability in US financial institutions in the UK feared that they, like their counter-parts based across the Atlantic, would soon be held accountable for their clients' contaminated land liabilities. The majority of respondents agreed that the fear of direct lender liability made many banks implement measures to ensure that the threat of environmental risk was significantly reduced.

I: What do you think have been the main drivers behind this increased appetite for environmental risk management amongst financial institutions?

R_{10}: I mean, I think it's fear, because while there is increasing law and some instances of real claims, or real, uhm, depreciation of value on an asset, there's, uh, not a massive library of cases, which you can throw at clients

[1508] Interview with Respondent 1.
[1509] Lawrence and Lee 'Permitting Uncertainty' (n 31) 261.

> *to show them exactly why they need to consider these things. What it is driven by is potential. And that potential then generates the fear factor, which is based on not being the one individual (what they call them at […] is 'Relationship Managers'), which are the people who affectively agree the deals and sign them off. They don't want to be the one that carries that risk, uhm, and as an organisation, they don't want to be the one that the public finger, or the government finger, is pointed at.*[1510]

The UK and USA are, in many respects, the pioneers of environmental risk management in bank lending. This may be attributed to the fact that both nations have a fully functioning system for historic land remediation.

> *I: What do you think environmental due diligence would be like if we didn't have the regime?*
>
> *R7: Well, I've seen environmental due diligence in lots of places, where the environmental law is far less stringent than here in the UK. Indeed, in places where there is no specific contaminated land legislation, I would say that, in that scenario, people are a lot more blasé about environmental risk.*[1511]

This attitudinal difference may be credited to the fact that the enforceability of direct lender liability for environmental risk in such countries has been virtually non-existent, and, as a consequence, there has been no incentive, no driver, or demand for banks to

[1510] Interview with Respondent 10.
[1511] Interview with Respondent 7.

implement a high level of due diligence in order to reduce the risks caused by the environmental issues that can be attributed to land and water contamination. Thus, countries with a lack of environmental legal exposure have taken on a different evolutionary spirit within their due diligence frameworks.

Despite the impact of the Part IIA regime upon its enactment, the chapter on historic contaminated land risk has shown that the contaminated land regime did not generate the amount of liability as some first anticipated; in fact, not one case of lender liability has been generated under section 78F of the EPA 1990. However, it may be argued that making people liable is not a mark of success. Land remediation is a sign of success. And the introduction of Part IIA drove the clean up of historic contamination through voluntary remediation and the planning system. The absence of any lender liability from the contaminated land regime might be due to the fact that Part IIA has issued few remediation notices. Conversely, it could also be because the banks based in the UK have learnt from the mistakes of the American lenders, and have therefore implemented their own due diligence measures in order to reduce the risks posed by the Part IIA regime. Concurring with this reasoning, Respondent 1 suggested in their interview that:

> *R_1: It was different over here because we learnt from that experience [meaning CERCLA liability in America] and what we said was, "Look, you're just going to dry up lending!" Banks are in business to assess risk and lend money. If we lend money and then we lend that badly for whatever*

> *reason… environment or another… then we can lose that money. But we shouldn't be held liable for any additional loses.* [1512]

While legal controls have been an extremely important tool for shaping and molding the current system of environmental due diligence during banks' commercial loan financing, the thematic analysis of the empirical data has demonstrated that the threat of legal exposures and compliance issues have been replaced as the most significant driver for the use of environmental due diligence in banks. This theme is aptly portrayed in Respondent 11's answer to the question of which drivers have influenced, and are continuing to influence, the growth of environmental due diligence in banks:

> *R_{11}: I think that if we look back fifteen years, the main drivers would have been legislative, but now I think we mentioned this before the interview started, around … uhm … like we engage with investment bodies … so I think we see the expectations of society for the driving behaviours of financial services …* [1513]

This respondent, whose view is shared by the majority of the interviewees, went on to suggest that, while the 'expectations of society' includes the society at large, the banks pay particular attention to the expectations of their primary stakeholders, e.g. investors (whether equity or debt investors) and a range of other third party bodies, such as green indices (FTSE4Good and the Dow Jones Sustainability Index), ratings agencies, and the government and NGOs. This finding corresponds to Respondent 5's observation

[1512] Interview with Respondent 1.
[1513] Interview with Respondent 11.

which suggests that emerging environmental issues, like climate change, are beginning to shadow the environmental concerns relating to land:

> *R_5: Due diligence is getting more and more important; if anything it's acquiring greater importance for a number of reasons; as far as I can tell: One, is that environmental risks are becoming greater. When I started, climate change was not even in the technical vocabulary of those in the field and only a few of us in the field really understood sustainability, for example. Now obviously, it is now something that many of the population are aware of, so if anything I think that due diligence is broadening its scope. It is not just looking at, "Is this site contaminated and what is their role in remediating it?" It also looks at how a company is performing and what is their role in climate change and combatting climate change – Are they a part of the solution or the problem?*[1514]

As suggested above, despite decreasing in significance, the threat of legal exposure continues to be a driver for the lenders' use of environmental due diligence. This is a point that was unanimously agreed upon by all of the respondents to the interview questions. Also, if a lender conducts due diligence, it can use the defence that it has, under specific legislation, acted reasonably during the provision of loan finance. Jarvis and Fordham highlight this point in their book on lender liability and environmental risk:

[1514] Interview with Respondent 5.

> '…paradoxically, the lender's "scrutiny" could earn it not only the status of potential defendant but an effective defence to any prosecution: for example, by showing "due diligence" under section 33 of the EPA.' [1515]

It is unsurprising that lenders consider legal exposure to be a limited driver to their use of environmental due diligence. Decreasing public sector influence in recent years has weakened many of the UK's environmental legal frameworks. This finding correlates with the data which suggest that lenders now consider direct lender liability to be a low risk in their business dealings. In order for legislation to become a primary driver for banks in the future, there would need to be a greater push from the regulators.

Now that legal liability risk exposure has been evaluated as a driver, the next section assesses the impact that the financial crash, which occurred in 2008, had on banks and their use and implementation of risk mitigation techniques for managing environmental risks.

B. Market Volatility

Chapter 1 of this thesis showed that the global financial market has been in a state of volatility since the fall of Lehman Brothers in 2008.[1516] In that Chapter, the impact that the economic recession has had on the economic incentives for contaminated land clean-up were assessed. In this chapter, market volatility (which has been created by the economic recession) shall be evaluated as a driver for the implementation of environmental risk reduction tactics in banks. In an interview, Respondent 9

[1515] Jarvis and Fordham (n 51) 167.
[1516] Refer to ch 1.

demonstrated how heightened market volatility has influenced the private equity firms' appetite for purchasing and selling toxic assets, which, in turn, has greatly changed how finance deals are structured, requiring a higher level of due diligence from banks:

R9: Basically, there is not so much money around! So if you go pre 2008 and you look at private equity, then it was relatively easy to get a significant investment from the banks to enable the equity to be highly leveraged, i.e. less equity was needed. The private equity companies were there able to buy assets by putting very little equity in, so they were able to leverage their equity very, very highly. If they had £100 million, they'd have no problem using that to do a £2 to £3 billion deal. Now that's changed because the banks 'structured finance guys', who were able to provide this high level of debt lending, whether it be primary debt, secondary, mezzanine, whatever, the structure since 2008 have not been able to do this at rates that are attractive. As we know, in 2008, the banks potentially collapsed. Lending therefore collapsed and so private equity firms literally stopped buying things, as they could not access these high levels of relatively cheap debt. They were also concerned about the value of these assets, as they began to see that some of the assets that were purchased in 2005, 2006 and 2007 were quickly worth a fraction of what they paid for them, because they basically overpaid in a 'bull' market.

I: Of course! Well that is a great summary of venture capitalists and why due diligence has increased since 2008. Why do you think it is still quite relaxed in commercial loan transactions, then?

> *R_5: I think it's because you don't often see companies going bankrupt because of environmental issues!*[1517]

Although an increasingly significant part of the lending process, it is important to note that amongst the numerous concerns that banks have to take into account when lending, environmental due diligence does not take centre stage in every commercial transaction, as Respondent 9 points out above. Nonetheless, since 2008, this has slowly begun to change and the empirical research data provide evidence to suggest that the financial crash has directly affected the way in which the UK's lenders conduct their environmental due diligence. The data illustrate that, before the financial crisis hit, property lending was extremely bullish and an altogether lucrative business. At this time, environmental due diligence, although being requested by some banks, was merely something on a list of things that the lenders needed to have approved before a loan was granted, and allocated, to a customer. With the onset of the financial collapse, however, environmental due diligence underwent a transformation. The fear of further economic loss and reputational damage meant that, during the economic crisis, environmental issues were referred upwards to higher authorities in the banks. When asked about what has driven environmental due diligence in bank lending, one respondent, who works for an external consultancy firm that carries out environmental due diligence for one of the UK's major clearing banks, suggested that, before the crash, environmental due diligence was not taken as seriously as it should have been:

> *R_{12}: People were saying, 'You need to get environmental due diligence', and they would go to an environmental consultant to get the due diligence;*

[1517] Interview with Respondent 9.

> *but we felt that the findings were being used to prop open a door; or, you know, settle a wobbly table; and they weren't being read or digested even. We thought that when the financial crisis hit everyone would become more astute on environmental risk because it was one of the exposures that needed to be considered. And what we saw was not necessarily a growing appreciation for that risk, but we saw an escalation – through the organisations – through the decision-making – and the people who would normally have made the call in relation to environmental risk, in particular, weren't prepared to put their necks on the line anymore. And the smallest issues were escalated up and up and up within a bank, if they were lending.* [1518]

While the arrival of specific environmental legislation established the widespread use of environmental due diligence amongst lenders, as the above respondent suggests, the financial crisis had a different, albeit just as significant, effect on the lenders' use of due diligence for alleviating environmental risks. For the first time since its initial development in the 1990s, environmental due diligence became more than a simple, tedious, tick box exercise; it developed into an important tool that was used to protect banks from a potentially severe risk exposure, i.e. the risks that environmental issues could cause.

The financial crash, and subsequent age of austerity, may represent both the best of times and the worst of times for British lenders. During this period some banks suffered crippling financial losses. Such losses were made worse by a number of scandals that

[1518] Interview with Respondent 12.

subsequently came to the fore (take, for instance, the PPI and Libor scandals), and further damaged the banks' reputations in the public eye. In the years since the financial crash, banks have lost public faith. They have become institutions that make the reasonable man wary and uncertain. Trust in banks has diminished significantly. Nevertheless, in times of economic turmoil and uncertainty, banks have begun to slowly reconstruct their moral integrity by supporting investments that are environmentally and socially sustainable, and ethically sound. During this period, the threat of suffering further financial losses has meant that environmental risk management is no longer viewed as another layer of bureaucratic decision making; it is now seen as a necessary feature of bank lending, which is gradually permeating its way through the risk management structure amongst the majority of banks operating within the Western hemisphere.

C. Corporate Social Responsibility and Green Supply Chain Management

After the data had been collected and analysed, it became evident that environmental due diligence had been driven by much more than legal and financial concerns. The development of environmental risk management methods in banks has also been greatly influenced by the broad concept of corporate social responsibility ('CSR'), and the growing demand for compliance with green supply chain management ('GSCM') systems, such as ISO 14001 (Environmental Management Systems).[1519] The related obligation of having to 'think green' has influenced many supply chains; and, with a

[1519] ISO 14001, 'Environmental Management Systems' (*iso.org*, July 2014) <http://www.iso.org/iso/iso14000> accessed 12 December 2014.

follow the leader, market herd instinct, lenders have also had to adapt to the changing business practices that have occurred over the last couple of years. Respondent 9, a supporter of ISO 14001, presents an argument which shows how CSR and GSCM have driven due diligence for environmental concerns in banks:

> *R_9: Where you are supplying someone else, and if that other person that you are supplying says, "Right you have to be environmentally friendly and you are required to operate ISO 14001 or equivalent systems", a bit like it was in the earlier days of quality control ISO 9000* [Quality Management Systems],[1520] *which was originally driven by the supply chain, where the main manufactures would say to their suppliers, "You have to operate in the same way that we do, in terms of quality insurance, so apply ISO 9000!" The same thing is happening with ISO 14001.*[1521]

The extract from Respondent 9's interview indicates that the banks' relationships with their customers have undergone a greening, and, in particular, that ISO 14001 has changed the way that banks and their customers conduct business. In agreement with the respondent's opinion, Arimura et al.'s research into GSCM assessed whether ISO 14001 has been a driver for increased environmental performance and voluntary action in supply chains.[1522] The results of their study show that the use of ISO 14001 encouraged more advanced GSCM practices, and that facilities certified with ISO 14001 were forty per cent more likely to evaluate the environmental performance of

[1520] ISO 9001, 'Quality Management Systems' (*iso.org*, 2011) <http://www.iso.org/iso/iso_9000> accessed 12 December 2014.
[1521] Interview with Respondent 9.
[1522] TH Arimura, N Darnall and H Katayama, 'Is ISO 14001 a gateway to more advanced voluntary action? The case of green supply chain management' (2011) 61(2) J Environ Econ Manage 170.

suppliers.[1523] As well as encouraging the assessment of performance throughout supply chains, there is also research which provides evidence of ISO 14001's positive impact upon the environment. In their research, Potoski and Prakash evaluated the use of ISO 14001 among three thousand facilities regulated under the US Clean Air. Their findings suggest that facilities that have adopted the ISO certificate are more likely to reduce their pollutant emissions than non-certified facilities.[1524]

As well as ISO certificates, there is also evidence to suggest that the greening of supply chains has been driven by the need for Equator Principles Financial Institutions (EPFIs) to comply with their Equator Principles (EP) commitments.[1525] Watchman et al. suggest that, 'Further, some banks have had a profound effect on "cleaning and greening" not only their own supply chains but, by using what influence they do exercise, also those of their own service providers and borrowers.'[1526] Indeed a business that is not 'green' in its outlook may not be well respected in the business world of today. Having a poor environmental reputation will ultimately affect an enterprise's ability to conduct business with banks and other commercial enterprises.

On the other hand, it may also be suggested that ISO 14001, and other forms of institutional rules, are quite often embedded into the formal structures of organisations to increase legitimacy with stakeholders, and to further enhance companies' competitiveness in the marketplace. Meyer and Brown stipulate that institutional rules are a source of 'myth and ceremony'.[1527] They purport that, 'the formal structures of

[1523] ibid.
[1524] M Potoski and A Prakash, 'Covenants with Weak Swords: ISO 14001 and Facilities' Environmental Performance' (2005) 24(4) Journal of Policy Analysis and Performance 745.
[1525] Watchman, Delfino and Addison (n 92) 97.
[1526] ibid.
[1527] JW Meyer and B Rowan, 'Institutionalized Organizations: Formal Structure as Myth and Ceremony' (1977) 83(2) American Journal of Sociology 340.

many organizations in postindustrial society dramatically reflect the myths of their institutional environments instead of the demands of their work activities.'[1528] Following this line of argument, Boiral believes that ISO 14001's effectiveness in greening corporate structures and supply chains is 'a rational myth'.[1529] After looking at Canadian organisations certified with ISO 14001, Boiral found that the companies that adopted the certificate tended to display superficial, ceremonial behavior, which was not focused on environmental performance.[1530]

Now that GSCM has been evaluated as a driver of environmental due diligence in banks, the section immediately below assesses credit and security risks and clients' eligibility as drivers for the banks' conduct of environmental risk management.

D. Credit and Security Risks and Clients' Eligibility

As with CSR and GSCM, the concept of 'Knowing Your Customer' ('KYC') [1531] is also becoming progressively important for modern banking practices. KYC helps banks to assess the potential liabilities of a future client and whether that client will be compliant with the law, and thereby able to repay its loan after it has been approved.[1532] Although it is sometimes difficult to imagine, the economy and environment overlap considerably, and the modern bank must now adopt a culture that considers the environment during its day-to-day business. A bank's decision to lend to unscrupulous clients that operate in particularly vulnerable sectors could lead to significant

[1528] ibid, 341.
[1529] O Boiral, 'Corporate Greening through ISO 14001: A Rational Myth?' (2007) 18(1) Organization Science 127.
[1530] ibid.
[1531] BIS, 'Customer Due Diligence for Banks' (2001) Basel Committee on Bank Supervision Working Paper <http://www.bis.org/publ/bcbs85.pdf> accessed 24 June 2013.
[1532] ibid.

environmental damage, which may not have otherwise occurred without the loan being granted. Issues surrounding borrowers' non-compliance could inevitably lead to credit and security losses for a lender. Lenders' reputations may also be damaged if they are subjected to scrutiny from NGOs and campaign groups for lending to certain sectors and companies. The indirect risks caused by having a borrower with environmental problems can be quite severe, but this depends upon a number of factors, e.g. the size of the company, the geographical location of a site or business enterprise, the environmental harm created, and/or the size of the individual loan. The extract below shows Respondent 2's opinion on the credit issues that can be caused by lending to environmentally sensitive clients:

> *R_2: But there are credit issues as well and there have been some banks that have been burnt by lending to a project, particularly… take a mine … and then all of the developments gone in the financing and there's campaigners against it and the mine has closed down and lost all the money, uhm, and that applies on a smaller scale when you've lent to a company and, let's say, when you go a mortgage on a, uhm, a scrap yard dealer, and they lose their licence because of the pollution of a river, and you end up being a mortgagee in possession. Yeah, so there's also those cases on a smaller scale.*[1533]

As a result of the increasing indirect threats, and the need to better know one's customers before and after the loan has been granted, the importance of environmental due diligence in commercial loan financing continues to take on a more significant role

[1533] Interview with Respondent 2.

in the banks' decision-making process. Consequently, because banks are requesting that their borrowers conduct their business with the environment in mind, due diligence for environmental concerns has begun to broaden itself both vertically and horizontally throughout both the banks and the businesses that they finance.

1. The Eligibility of Particularly Risky Clients

A common method to mitigate for particularly risky clients is to create a system for the categorisation of customers by the threat that they pose to the bank. Such categories are normally created by the development of internal threshold limits within each individual bank, which explains why every bank interviewed had nuanced differences for determining clients' eligibility before the grant of a loan. Normally the risk thresholds are sector led, but banks do also factor in the size of the loan for which application is being made into their determination of eligibility, too. There are also universal frameworks that lenders can use to assess clients' suitability: for example, the EP can be used as a method of safe lending during project finance transactions over $10 million.[1534]

Costing the involvement of some of the banks' clients demonstrates that some are much more of a threat than others, especially when it comes to direct liability for suspect land.

> *R_5: We would look at how the company's involvement is translated into costs … If a company has Superfund sites they must disclose that amount on their financial statements because they tend to be material. Unless you*

[1534] infra, pg 313.

> *have a .001 responsibility for a site that will take $100 million to clean up, it may not be a material amount. Generally companies in the US, especially the public companies, they do a 10K or 20F if their foreign filter will disclose. What we will usually ask companies to do if they are involved is to disclose because if an investor … if you are doing an IPO, for example, an investor has a right to know that this is something that you have on your balance sheet. It may not be that scary, for example – General Motors, General Electric, Exxon – they have a lot of Superfund sites that they are dealing with on a daily basis. Nobody would say that any one of those sites, or even all of those sites, would floor the company from a financial standpoint. So, we look at it that way. Smaller companies with a large liability, well, we'll obviously take those into account, and that's part of the due diligence process that the guys on the finance side do.* [1535]

While environmental risk management practices are carried out on a case-by-case basis, the majority of banks have established a system for assessing the risks that may stem from certain 'vulnerable operations'. A particularly risky customer is one likely to operate in, what the bank considers to be, an environmentally sensitive sector. Although this is not universally applied, the majority of banks normally divide the high-risk sectors into four primary categories:

- Basic Materials, e.g. mining operations, oil and gas companies, deforestation;

[1535] Interview with Respondent 5.

- Heavy Manufacturing, e.g. companies dealing with hazardous chemicals;

- Agricultural Businesses, e.g. intensive farming practices; and

- Power Plants, e.g. power stations producing nuclear energy.

A company's size is an extremely important determinant for a bank when evaluating eligibility. Depending upon whether a company is a large, mid-sized or a small enterprise will affect a bank's appetite to lend. Financial institutions usually feel the most comfortable when lending to large corporates, since the majority of trans-national corporations (TNCs) often possess their own environmental risk management teams and have the financial provisions to pay for any clean-up costs that are brought about because of their business activities. While the magnitude of the risks to a bank could be far more harmful if environmental issues do arise from a TNC's operations, the threat of the risk occurring is usually considerably lower. Small to medium sized enterprises (SMEs), on the other hand, are much more of a risk, especially when uneducated in environmental risk management practices. This point is emphasised by Respondent 6:

> *R_6: The biggest risk clients aren't, typically, the ones that people think of; they're not, typically, the steel mills; they're not, typically, the petrol chemical plant, because they do have environmental people on staff; they do have, especially if they are a private sector company… they are going to be aware of the regulations and will be aware of what their obligations are, they are much more in the public eye. The ones that really cause us more grief than any others are your dry cleaning sites and your typical service stations – gasoline. The reasons that they cause more problems than*

> *the bigger sites are: (a) because there are more of them; and (b) because their liquids are everywhere and, at the same time, when they do contaminate something, they usually don't have the money left over to do the clean-up.*[1536]

Therefore, in recent years, lenders have begun to educate and improve (especially with SMEs operating in vulnerable sectors) their clients' personal application and use of good environmental risk management practices. Companies that are the most likely to create environmental liabilities must be educated in environmental risk management. For banks, the ability to educate their clients acts as a preventative measure, which reduces the long-term risks that may be posed to them. As Respondent 6 states, an uneducated SME with little financial assurances, working in an environmentally sensitive area, is a particularly onerous client for a bank. A common example that is typically used to denote such an onerous customer is presented in Respondent 1's interview transcript, as:

> *R_1: … a £20,000 loan that is provided to a high-street dry cleaner or single-site waste transfer facility.*[1537]

Even though a loan this size is not a great amount to a bank, if a borrower causes a £1,000,000 worth of damage in legal and remediation costs as a result of the pollution that was created during the course of its business operations, and the lender is then left to pay for the costs of remediation after the company's dissolution, then the loan to

[1536] Interview with Respondent 6.
[1537] Interview with Respondent 1.

damage ratio for such a mundane transaction suggests that a significantly high risk has actually materialised.

2. The Effect of Environmental Risk on Lenders and Borrowers

In relation to the interview data collected, it seems that the introduction of specific environmental regulations have greatly affected some of the lenders' clients; such customers tend to work in dirty industries. While borrowers are required to put in place measures that comply with legally imposed improvements, lenders can simply refuse to lend money to particularly risky customers and, in so doing, are therefore absolved of any environmental risk. Respondent 10 shows how some borrowers are much more at risk than lenders:

> *I: Has environmental regulation affected both borrowers and lenders?*
>
> *R_{10}: Well, it would affect borrowers more than lenders, right – so, lenders would be affected as a result… indirectly… because their clients are affected.* [1538]

The data also show that the growing regulatory pressures for the protection of the environment are believed to continue to be a burden for banks' clients' ability to repay their loans.

[1538] Interview with Respondent 10.

I: Right, excellent, uhm, so has the implementation of environmental regulation affected both lenders and borrowers?

R_{11}: I think it has definitely affected borrowers because, and in a naïve sense, I would argue that the legislative burden is only increasing for borrowers. Especially, since we are seeing the government trying to meet sustainability and green requirements, as well. So, you see things, like, the Carbon Reduction Commitment (CRC), and it is not surprising in the sense that there'll always be a certain level of non-compliance; but, nonetheless, given the sophistication of companies covered by the Carbon Reduction Commitment, it is, nonetheless, surprising that some companies fail to comply and therefore get substantial penalties for doing so.

In order to make sure that these risks do not materialise, the bank will attempt to get to know their client during their pre-transaction due diligence. Lenders must establish a good client base, which will make them more money in the future because they can more or less guarantee good returns on their investments. It may not be far wrong to suggest that the whole life cycle of commercial loan financing is therefore underpinned by the banks retaining good clients, which are unlikely to become insolvent and default on their loan repayments.

E. Credit Risk Management Frameworks for Managing and Limiting Environmental and Social Risks in Project Finance Transactions

There is evidence to suggest that credit risk management frameworks for managing and

limiting environmental and social risks in project finance transactions have driven the use and development of environmental risk management in banks.[1539] This is because, as Wright and Rwabizambuga propose:

> 'In recent years, changing public expectations have increasingly induced firms to publicly declare their commitments to integrating a wide variety of public interest concerns into their corporate practices.'[1540]

The aim of voluntary environmental frameworks, like the EP, is to encourage sustainable project management, and financing by global self-regulation.[1541] Socially responsible investing (SRI) for project finance is seen by the widespread use of the EP amongst the international lending community, which Hardenbrook describes as, 'the private financial sector's attempt at environmental responsibility.'[1542] Since, 'finance is the grease of the economy',[1543] financial institutions are capable of 'greening' the project finance transactions that they are involved in, and, in so doing, directly impacting upon the economic structure.

From the above discussion it is clear that there has been a general change in attitude amongst the lending community towards environmental due diligence. It is clear from the data collected in the empirical study that the adoption of voluntary credit risk

[1539] B Scholtens, 'Finance as a Driver of Corporate Social Responsibility' (2006) 68(1) Journal of Business Ethics 19.
[1540] Wright and Rwabizambuga (n 92) 89.
[1541] D Garvin, 'Can Industry Self-Regulation Work?' (1984) 25(4) California Management Review 37. See also, N Gunningham and R Joseph, 'Industry Self-Regulation: An Institutional Perspective' (1997) 19(4) Law & Policy 36; and Clayton (n 92) 173.
[1542] Hardenbrook (n 92) 197. See also, C Wright (2009) 'Setting standards for responsible banking: examining the role of the International Finance Corporation in the emergence of the Equator Principles' in F Biermann, B Siebenhüner, and A Schreyögg (eds), *International organizations and global environmental governance*. *Routledge research in environmental politics*. (Routledge, London 2009) 51-70.
[1543] Scholtens, 'Finance as a Driver of Corporate Social Responsibility' (n 1539) 19.

management frameworks by the bank lending community has contributed significantly, as a CSR driver, to the banks' internal use and development of environmental due diligence. Respondent 8, for example, stated in interview that the EP are a 'highlight' of environmental due diligence in banks:

> *I: So, how has it* [environmental due diligence] *evolved? Has it been recently that this appetite has come about?*
>
> *R8: Environmental due diligence is something that started a few years ago in banking. I think one of the highlights of it was the Equator Principles, which refers to managing environmental and social risks, but it had a bit of emphasis on environmental issues in the sense that consultancy and also engineers, technical engineers, yeah, they are more focused on the environmental side. It's been a few years and the consultancy world has captured on that a lot, so we can find very good consultants that can help us to undertake the environmental due diligence that we need.* [1544]

The above interview extract is significant because it follows the findings of previous empirical work on the EP. In a 2005 survey conducted by Freshfields Bruckhaus Deringer, the EP are described as 'a shining beacon of responsible banking'.[1545] Such a description emphasises the important impact and success that the EP have had upon the financial sector, generally. However, it is important to note that not all banks have adopted the Principles. Scholtens and Dam suggest that while there are significant

[1544] Interview with Respondent 8. Brackets added.
[1545] See, Freshfields Bruckhaus Deringer, 'Banking on Responsibility: Part I of Freshfields Bruckhaus Deringer Equator Principles Survey 2005: The Banks' (London, Freshfields Bruckhaus Deringer, 2005) 1.

differences between the EPFIs and non-EPFIs' environmental, social and ethical policies, the banks that adopt the EP tend to be large banks that have the resources to implement the EP;[1546] therefore, the size of the bank plays an important role in the greening of its corporate governance structures.

The EP, a set of voluntary principles, were first established by ten banks in 2003. At the beginning of the third edition of the EP document it says:

> 'Large infrastructure and industrial Projects can have adverse impacts on people and on the environment. As financiers and advisors, we work in partnership with our clients to identify, assess and manage environmental and social risks and impacts in a structured way, on an ongoing basis. Such collaboration promotes sustainable environmental and social performance and can lead to improved financial, environmental and social outcomes.'[1547]

Since 4 June 2013 the document that outlines the scope and application of EP II has been updated; the latest version of the EP is now called EP III. To date, seventy-nine financial institutions throughout the globe have adopted the voluntary framework as an actual source for reducing environmental and social risk.[1548] It must be noted, however, that the interviews for this thesis were held before EP III entered into force. Consequently, the term loans that were discussed in the interviews would not have been covered by EP III. Nevertheless, the importance of EP I and II in driving environmental

[1546] Scholtens and Dam (n 92) 1307. See also, BankTrack, 'Unproven principles. The Equator Principles at year two' (Amsterdam; BankTrack, 2005) <file:///C:/Users/Lloyd/Downloads/050606_unproven_principles_the_equator_principles_at_year_two.pdf> accessed 12 December 2014.
[1547] *EP* 2013 (n 1373) 2.
[1548] ibid.

due diligence in financial institutions means that it is still necessary to discuss the Principles in this chapter.

EP III concerns project finance situations that are likely to cause environmental and/or social harm. The framework applies to four types of financial product: (1) Project Finance Advisory Services; (2) Project Finance; (3) Project-Related Corporate Loans; and (4) Bridge Loans.[1549] It is the aim of the EPFIs to: 'Ensure that the Projects we finance and advise on are developed in a manner that is socially responsible and reflects sound environmental management practices.' [1550] From the range of financial products covered by EP III, along with the aim of the EPFIs, it would appear that the EP have a significant role to play in financial institutions' project finance transactions, as well as the greening of their due diligence processes.

The EP apply to all projects that have a capital expenditure of US$10 million and over. The financial threshold was originally set at US$50 million in EP I, but this was later amended by EP II. The lowering of the financial threshold is essential for the thesis' analysis of the primary drivers of environmental due diligence in UK banks. The thesis is concerned with land redevelopment. However, the costs associated with redevelopment projects rarely exceed US$50 million. On the other hand, the lower financial threshold of US$10 million is much more likely to capture lending institutions' financing for land redevelopment projects. It is therefore reasonable to suggest that the EP have had, and are continuing to have, a significant influence upon

[1549] ibid 3.
[1550] ibid.

the lenders' role in financing land redevelopment projects; and this is especially so throughout the EPFIs.

The EP encourage better due diligence for environmental and social risks and impacts among the EPFIs. According to the EP, projects should be categorised by the EPFIs' environmental and social due diligence. During the due diligence's analysis, the level of environmental and social impacts should be reviewed.[1551] Altogether there are three categories of project under the EP. While Category 1 includes projects 'with potential significant adverse environmental and social risks and/or impacts', Category 3 projects are described as presenting a 'minimal or no adverse environmental and social risks and/or impacts.'[1552] In between Categories 1 and 3, Category 2 projects pose 'potential limited adverse environmental and social risks and/or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.'[1553] The EP's project categorisation induces environmental and social due diligence amongst the EPFIs. However, while Categories 1 and 3 may be easily distinguishable, Category 2 projects may be much more difficult for EPFIs to assess through their conduct of reasonable due diligence. There is also the problem with 'categorisation-creep', which refers to where projects are purposely downgraded 'to reduce costs, time and effort.'[1554] Categorisation-creep can be detrimental to the use of the EP, which, in turn, can heighten the risk of environmental and social issues arising throughout project financing. The adoption of the EP by financial institutions should be celebrated for the fact that it demonstrates, 'the public's ability to influence of

[1551] ibid.
[1552] ibid 5.
[1553] ibid.
[1554] Watchman, Delfino and Addison (n 92) 89.

private action'.[1555] The introduction and development of the EP have changed banking due diligence for both EPFIs and non-EPFIs. And the EP's impact is clearly not limited to project finance. The data collected by this research show that EP-like due diligence techniques are being used by banks to assess the environment-related risks that may occur while lending to land redevelopment projects. It has already been shown, for instance, that financial institutions very often utilise the expertise of external environmental consultants to categorise the environmental risks that can materialise when lending to individual clients and/or land redevelopment projects.

As well as the categorisation of activities, the EP have encouraged lenders' environmental due diligence in other ways. For example, Principle 8 of the EP concerns 'covenants' that are to be incorporated in the financing documentation; this documentation must comply with the host country's environmental and social laws and regulations.[1556] The previous chapter (Chapter 6) has already demonstrated that the insertion of conditions precedent in the loan and security documentation is an environmental due diligence technique that is widely used by banks in their day-to-day loans with commercial borrowers. This is significant because it demonstrates how the EP have had a positive influence on the banks' risk management structure.

On the other hand, the EP have been criticised for possessing a narrow scope and a lack of accountability and transparency.[1557] And, from a stakeholder perspective, the legitimacy of the EP has been widely condemned.[1558] O'Sullivan and O'Dwyer believe

[1555] Hardenbrook (n 92) 231.
[1556] *EP* 2013 (n 1373) 3.
[1557] Watchman, Delfino and Addison (n 92) 89. See also, M Forster, PQ Watchman and C July, 'The Equator Principles – Making A Difference? Part 2' (2005) 7 JIBFL 253.
[1558] N O'Sullivan and B O'Dwyer, 'Stakeholder perspectives on a financial sector legitimate process: The case of the NGOs and the Equator Principles' (2007) 22(4) AAAJ 553.

that, from an institutional level, the EPFIs need to do more to ensure greater accountability to the EP.[1559] Missbach has also discussed the EP from an NGO's perspective.[1560] He compares the EP with the Collevecchio Declaration (CD),[1561] which he suggests is preferred as the 'broader NGO vision of sustainable finance'.[1562] Like the EP, the CD on Financial Institutions sets outs a number of Principles that banks should follow in order to advance environmental and social sustainability.[1563] The main difference between the EP and the CD is that the Declaration was established by BankTrack, a 'global network of civil society groups'.[1564] Because the Principles in the CD were created by civil society groups, it may be argued that the Principles in the Declaration require signatories to adhere to stricter levels compliance and transparency than the EP.

Some opponents to the EP argue that the framework presents banks with the opportunity to 'greenwash' their operations in developing countries.[1565] With regards to the 'greenwashing' of corporate identities with the EP logo, Wright and Rwabizambuga argue that, '…codes of conduct are primarily adopted by firms as signaling devices for demonstrating positive credentials, with the aim of strengthening corporate reputation and organizational legitimacy more generally.'[1566]

Research concerning why banks have refused to join the EP shows that non-EPFIs may

[1559] ibid, 578.
[1560] A Missbach, 'The Equator Principles: Drawing the line for socially responsible banks? An interim review from an NGO perspective' (2004) 47(3) Development 78.
[1561] BankTrack, 'Collevecchio Declaration' (*BankTrack*, no date) <file:///C:/Users/Lloyd/Downloads/030401_collevecchio_declaration_with_signatories.pdf> accessed 12 December 2014.
[1562] Missbach (n 1560) 78.
[1563] BankTrack (n 1561) 1.
[1564] BankTrack, 'About Bank Track' (*BankTrack*, no date) <http://www.banktrack.org/show/pages/about_banktrack> accessed 12 December 2014.
[1565] Scholtens and Dam (n 92) 1307.
[1566] Wright and Rwabizambuga (n 92) 90.

be just as well suited for managing environmental and social issues during project finance.[1567] While some non-EPFIs have shown scepticism toward the EP, others have simply not adopted the framework because the EP are viewed as 'business as usual', and the non-Equator banks' internal CSR functions are therefore adequately dealing with any environmental and social issues that may arise during their loan finance activities.[1568]

Financial institutions that are a part of the EP appear, to outsiders, to have more concern for CSR commitments; in reality however, this may not be wholly true. Macve and Chen's research into the success of the EP identifies the bank's reputation in the public domain as the primary driver for the financial institutions' adoption of the EP.[1569] They state, 'Some banks are more public relations focused than others because they are always in the press spotlight, so "Will this pass the Daily Mail (i.e. popular newspaper) test?" is always a relevant question.'[1570] This may mean that the EP are a form of publicity, and that some of the EPFIs are more concerned with the bank's reputational risk and relationship to the public at large, as opposed to advocating and furthering sustainable financing. Further to this, there are limited data on the EP's success in protecting the environment; this is primarily because it has proven difficult to evaluate the impact that the EP have made in preventing environmental and social harm in project finance.[1571]

[1567] M Forster, P Watchman and C July, 'The Equator Principles – Towards Sustainable Banking? Part 1' (2005) 6 JIBFL 217.
[1568] ibid.
[1569] R Macve and X Chen, 'The "equator principles": a success for voluntary codes?' (2010) 23(7) AAAJ 890, 897.
[1570] ibid.
[1571] ibid, 898.

As discussed above, though some view the EP as a form of publicity for banks to build public relations and legitimise their internal corporate governance frameworks, after a number of years of use most banks now consider the EP to be both a binding international framework, and a universal indicator for good environmental and social risk management practice. This fact is evidenced by the findings of Scholtens and Dam's study into the EP. The results of their study have shown how the EP are now 'used to signal responsible conduct' amongst the modern banking world.[1572] Thus, voluntary credit risk management frameworks can be described as being an important driver for the use, and continued growth of, environmental due diligence methods in banks.

F. Reputational Risk

Banks are now operating in an age of environmental responsibility and accountability. And financial institutions have an increasingly large role to play within the agenda for environmental protection. Although difficult to perceive, the provision of financial assistance can harm the environment. Notwithstanding the possibility of irreversible environmental damage, irresponsible lending could also cause serious harm to the reputation of the bank that provides the money to a polluting borrower in the first instance.

The data in this section suggest that the threat of incurring reputational risk is presently the main driver for the banks' use of environmental due diligence. Such data provide an answer to sub-question 3, point 2, and, during the analysis, were coded into the

[1572] Scholtens and Dam (n 92) 1307.

yellow coding category and highlighted in red. The evident theme in the data is that pressure from the public and NGOs is currently driving due diligence for environmental risks. In interview, Respondent 5 spoke of how public campaigns against banks' lending decisions have influenced their decisions of whether or not to finance environmentally contentious activities:

> *R_5: But in the past there have been campaigns against banks. I remember one TV commercial with the actress Susan Sarandon, for example, cutting up a credit card. I can't remember if it was […] or […] because of the environmental issue and impact that the bank had. We are also seeing, and I am sure that all banks see this, we are seeing a lot of push from the NGOs directly. They are regularly contacting us and letting us know about the projects that they are concerned about, carrying out pre-empting strikes. Even before a client approaches us they are telling us that if a certain project were to be financed by the bank, uh, it would be held against us. So, I'm seeing a lot more activism. Again, not so much in the sense of people going down into the streets and protesting, but much more subtle, more professional, and a push in that direction. So the driver can definitely be contributed to the relationship that banks have with NGOs and certainly with the everyday investors who may be concerned about the environment. They may cycle, and do a lot of things at the community level, so they expect the companies that they invest in, and the companies that finance those companies, in turn, to be just as responsible.*

The banking respondent identifies reputational risk and public perception as a key driver for environmental due diligence in this section of the interview. They describe

the response of the Rainforest Action Network (RAN) to Citi Group's financing of deforestation projects. In response to Citi's lending decisions, RAN aired a television advertisement which showed celebrities, including Susan Saradon, cutting up Citi credit cards. The respondent's description of NGOs is also interesting, since it seems that the NGOs' approach to activism has changed over the years. From the respondent's account, it seems that the NGOs have become more 'professional' in their approach to driving the banks' decision-making. This finding is interesting because as the banks have developed more fine-tuned environmental and social risk management methods, the NGOs have also evolved better methods for holding the banks to account.

Though inevitably linked with CSR, GSCM and KYC, the interview data suggest that the banks' reputations have overtaken legislative compliance as the most important driver for the conduct of environmental due diligence within their risk management process. This may have something to do with the fact that reputational and project risk have become the greatest environmental threats for banks. Lenders are currently fearful of the reputational ramifications that their actions may bring; and this is especially so with regards to their relationships with NGOs and campaign groups. A general theme throughout the interview data was that the majority of bankers interviewed showed how NGOs have pressurised banks into adopting good environmental risk management functions within their ordinary risk management frameworks. The reputational repercussions that may emerge from lending to an environmentally or socially contentious project have made banks turn away some lucrative financing opportunities. The affect that NGOs have had upon lenders is summed up well in respondent 2's interview transcript:

> *R_2: Generally, a lot of it has been pushed from NGOs and campaigns. So we were campaigned over the lending to oil and gas companies, and the climate camp on lending to companies involved in the manufacture of highly controversial weapons… uhm… there's been a lot about targeting banks in the US about mountain top removal; forestry companies and deforestation; animal welfare and animal testing. And the NGOs have got cleverer and cleverer at not only targeting the companies that have direct responsibility and operational responsibility to do things, but also their financiers.*[1573]

Over the last twenty years, compliance with environmental legislation and regulation has become second nature for some lenders, and this is also true for the majority of their commercial clients. The uncertainties that were initially created by legislation, like Part IIA, have been relinquished over time, and the due diligence that is necessary to remove the threat of such legislation has, in many ways, become deeply embedded within the risk management process of most (if not all) of the UK's lending institutions. The general consensus amongst the interviewees was that banks are beginning to feel more comfortable with resolving compliance issues, and can therefore concentrate more on improving both their reputations and public image. Thus, when asked about the greatest driver for banks at the moment, one respondent said:

> *R_{14}: The single most important asset that banks have is their reputation. Managing that reputation and managing reputational risks comes in many different forms, and there are a lot of facets to it, but environmental and*

[1573] Interview with Respondent 2.

> *social risks are a very important one; and one that banks have been, if I may say so, successful in the last few years in managing that, in comparison to their management of some other reputational risks* [1574]

This extract from the interview data shows that times are changing. The banks' previous obsession with direct lender liability for environmental risk under, *inter alia*, Part IIA and the other regimes that complement its operation, is beginning to fade. The more traditional environmental risks have been around for some time now, and the banks have become accustomed to assessing such risks within their credit due diligence functions. This finding corresponds to Chapter 5, which shows that direct lender liability is now perceived as the least likely risk to materialise within commercial loan financing. Banks' reputational risk management and fear of bad PR and public scrutiny should, however, continue to drive the future application of environmental due diligence in commercial lending for some years to come.

> *R_5: I think one thing that is my challenge is when it comes to looking at companies' reputation the information out there is not standardized. Money is money! It is easy enough to measure a company's performance from a financial standpoint, but reputation is really hard to (a) define and (b) to quantify or even frame. So the push back that I get sometimes is – if I say that a company has a less than stellar reputation, then the question is, "So what? What is the impact? What is the tie between that reputation and how bad is the reputation on a scale of 1 – 10?" I don't have that answer because there is no scale when it comes to reputation; there is a huge gap*

[1574] Interview with Respondent 14.

> *for me. I know there are organisations that try to put information in there, they monitor the media, you know, and how many times has that company's name appeared negatively in the press. That's only one aspect of someone's reputation; you really have to get behind the management and community issues, which may not be in the press regularly. That takes a lot of research. There's a huge gap when it comes to putting a mark on an environmental reputational of a company.*

The importance of this section can be attributed to the conclusion which it draws in answer to the overarching research question and sub-question 3 – that the primary driver for environmental due diligence in banks has changed from legislative to reputational over the last twenty-five years. Now that the drivers for environmental risk management have been highlighted, the next section provides an insight into how lenders really conduct environmental due diligence and the types of approach they can take.

II. How Do Lenders Manage Environmental Risks?

This Chapter has established that, in relation to credit finance, the general purpose of environmental due diligence is to allow an enterprise to undertake an assessment of the risks that may be present within any given business venture. This chapter has also shown that, in many respects, legal due diligence is now becoming increasingly fashionable within many business sectors; and environmental risk management in contractual relationships may, after many years of being perfected, now be described

as a precise science[1575] that has reduced the threat of environmental liability to a manageable level, with which the majority of banks are comfortable. But how is due diligence really practiced by banks? This section of the chapter seeks to assess the actual structure and use of due diligence for environmental risks in twenty-first century bank lending.

Methods for calculating the different environmental liabilities that may be present upon land (especially, with regards to liability under the Part IIA regime) have now become a necessary part of the lenders' risk management process. This thesis argues that the direct liability that lenders can incur from land based pollution no longer poses a primary concern. This is why environmental risk management teams will often look at how much they can take before the bank is put at risk.

> *R_1: It centres more on how much you can take without incurring direct lender liability.*
>
> *I: You would take possession then, even though there may be a direct risk?*
>
> *R_1: Yes, it depends what the risk is, but, if we get to taking possession we would have done something beyond the desktop; we probably would have had a site visit; we would have had a look at what was going on; what the market was like. Most sites you can sell, but we have had a lot of problems with waste transfer stations when they go bust, because when they go bust – for about the previous six months – they open their doors and everyone*

[1575] C Davis, 'Is legal due diligence to become a science?' (1997) 18(7) Comp Law 183.

> *comes in and they shut their doors. You can't sell that site without removing the waste, so that has an impact, both, on the value and saleability – as well as – because you wouldn't want to be taking possession of that sort of property. So, you know, we do make losses in this area, but they're not significant losses, not on a portfolio basis.* [1576]

Where environmental risks are present upon a site – and those risks pose a likely and severe threat – rather than taking on the liabilities and risks that are attached to the land by taking possession of the property, banks can simply 'walk away' and abandon its customer's site. In that situation it is highly likely that the bank will experience financial loss (it may even incur reputational harm); however, the threat of direct lender liability will not be incurred. Despite being a prominent issue when lending to real estate, abandonment tends not to happen too often in commercial banking, as Respondent 6 demonstrates:

> *R_6: The only one that we've walked away from, and we have done this a couple of times, was actually residential properties. Because the property wasn't worth that much to begin and the contamination issues were fairly huge in terms of what we would gain on it. In those instances, we have said, "Here's the keys, it's yours and do what you like with it!" For commercial properties, it doesn't tend to be the case, we tend to realise what we can out of it. There was only one instance where we handed the keys back to a*

[1576] Interview with Respondent 1.

> *company of a contaminated property, and they sent them straight back and said, "It's still your problem!"*[1577]

As exhibited in Chapter 2, the likelihood of a bank ending up with a piece of contaminated real estate is, gradually, becoming increasingly rare. While a great deal of uncertainty still exists as to the exact amount of contaminated land that is situated throughout England, the historic legacy is inevitably beginning to shrink. The decreasing amount of contaminated and suspect land around the UK can be attributed to voluntary remediation and the use of the planning system, which have both been responsible for generating a significant amount of contaminated land remediation since the regime's initial inception in 2000.

Some banks are much more environmentally and socially astute than others. Simply clicking on the different banks' websites and looking at their environmental, social and ethical policies will verify this fact. Throughout the empirical study it became clear that all of the major banks now have environmental risk management teams, which develop environmental policy for the bank. The members of these teams hold managerial positions within the bank, and have either transferred into the area from the credit / reputational risk management side of the bank, or have specialised in this field of banking. The bankers that were interviewed from the UK, Europe, the USA and Canada showed that the banks' environmental risk management frameworks are all set out in a similar way, i.e. using a system of credit risk assessment to determine environmental threats on a loan. However, upon closer inspection, it is apparent that each institution will tweak the due diligence process in order to suit the bank's individual business

[1577] Interview with Respondent 6.

ventures. For example, one of the risk management teams that were interviewed worked for the finance department (essentially the bank) of a blue chip company. Amongst many other business ventures, the company, for which the finance team creates environmental policy, rents specialist equipment, such as: medical equipment to hospitals, industrial equipment to major manufacturing operations. Renting equipment is an activity that traditional banking institutions would not participate in. Nevertheless, this is a business activity that is susceptible to environmental risks and the finance team for that company, who had a very good knowledge of environmental risks in banking, had to design an environmental due diligence strategy, which would protect the company from the environmental risks that may impact upon their individual transactions during the renting of equipment.

Despite the fact that each individual bank will customise an environmental risk management strategy to tailor its own form of banking activity, the data have found that there are two primary approaches that can be used to categorise the position that banks can take when exercising environmental due diligence to manage environmental risks. Some banks use, what may be described as, 'a risk-based approach' to the assessment of environmental issues. Others tend to adopt 'a liability-based approach'. Respondent 2 describes these two approaches further:

> *I: How do you think direct lender liability has impacted upon the banks' approach to lending money?*
>
> *R_7: I think it's made banks, and I am answering this from my time at […] […], I think it made us much more cautious about lending or purchasing assets; it made us less likely to lend money; but, the honest truth, is that it*

> *depends on the tolerance to risk of each individual organisation. There are lending organisations out there that play it very fast and loose, and are quite happy to say, "Well, look, these are the odds that this liability will never materialise, and therefore we'll go ahead with it, and we think we'll be okay!" then there are people like […] who follow the American legal model, which is that you want to make sure that you are water tight in every respect, so you don't end up being sued into non-existence, which is the kind of world that […] lives in, in the States; and their focus is exclusively on the potential liability for them, rather on the risk for them. So, it depends, one takes a risk-based approach, and one is a liability-based approach, which determines the attitude of the overall company to lending.* [1578]

Although this is somewhat a generalisation, the liability-based approach is normally associated with American and Canadian lenders; this could be related to the fact that the American banks have witnessed a period of lenders' liability for environmental pollution issues. Such an experience has consequently resulted in stricter methods of environmental due diligence for the banks based there. With the liability based approach the bank essentially assesses the threat of a risk on the basis of the liability that may be created from a particular transaction. Conversely, banks operating in the UK and Europe tend to take more of a risk-based approach when evaluating the issues that may be created from environmental concerns in loan financing. Banks based in such countries are therefore more willing than the American banks to take chances, but are still stricter in their application of environmental risk management when compared

[1578] Interview with Respondent 7.

to the environmental risk management methods that are being used in the emerging markets.

In commercial lending, environmental risk management normally sits somewhere in between banks' credit and reputation risk management functions; this is because environmental issues may directly affect credit finance (i.e. loan repayment and assets given as security), and/or a bank's reputation and public image. As Chapter 5 demonstrates, the latter is increasingly becoming the greatest concern for lenders. Nowadays, a majority of banks will make a conscious effort to understand and evaluate environmental and social risks. The increasing threats from these new sources of risk have forced banks to increase the size of their environmental risk management teams, and employ people with a professional expertise in the area of environmental liability. One banker interviewed said:

> *R_2: I used to be an environmental consultant [and] because such issues increased a lot… there are teams of generally 4 – 6 people in the bigger banks, uhm, across the board.* [1579]

Another respondent believed that the main purpose of environmental due diligence in bank lending was to protect the bank's reputation, as well as identifying particularly risky clients. This is a process that the interview participant described as, 'separating the wheat from the chaff':

[1579] Interview with Respondent 2.

I: Well, okay, my first question is quite an easy, general question, I suppose. I just want to ask whether environmental due diligence is important within 21st century banking?

R3: Yeah, I would say, yes, and certainly I would say that the fact that we have a team here of six people, who do environmental and social risk due diligence on […] transactions is evidence of that fact. And all the big banks have teams, uhm, not quite as big as we have here, but definitely teams that are equivalent to us, and what we do. So all the banks that you can see here: HSBC, Bank of America, Merrill Lynch, Standard Chartered, uhm, BNP Paribas, Santander, Goldman Sachs, RBS, you know, all the sort of big banks, have got a team of people that look at environmental and social risks, uh, mostly from a reputation protection point of view; the idea being that, uhm, you know, the banks don't support industries that are, you know, too damaging to environment or social capital, uh, you know, so our job is to advise […] as to, uhm, the merits, or demerits, of what it is proposing to support. I mean, it doesn't necessarily mean that we avoid to support certain industries; it's more a question of separating the wheat from the chaff, as it were, and trying to identify the best operators to work with.[1580]

Respondent 3 suggests that the majority of large commercial lenders now have an environmental risk management team of four to six people. While a team of four to six people seems small, it wholly reflects the type of risk that is being managed. The growth of environmental, social and ethical considerations within banks is rather unimaginable,

[1580] Interview with Respondent 3.

bearing in mind that a little less than twenty years ago such issues were viewed as a separate sphere of concern to the anthropocentric, financial world. Even though the banks' previous attitude towards non-financial concerns has softened, considerably, the extent to which environmental due diligence will continue to grow in the future is merely a subject of speculation. Nonetheless, it seems that as long as environmental regulation and risks expands and develops, so too will the lenders' use of due diligence to reduce environmental risk.

III. When is the Use of Due Diligence Most Important?

This section helps to understand 'when' in the lending process banks fear the threat of the environment risks the most. Assessing the most important time at which to conduct environmental due diligence answers sub-question 2, point 3 of the research questions. The data that are displayed in this section were highlighted in blue and underlined in black during the analysis stage.

The fallibility of environmental risk management is summed up well by Respondent 9, who, in their interview, likens financial institutions' management of environmental issues to an old S.E.A.T. television advertisement:

> *I: And, like you said, one of the biggest problems with due diligence is that you cannot prepare fully for the things that may happen.*
>
> *R_9: Yes, that's right. I am an engineer, and if man designed it, it will fail. The question is – When and how?*

I: Yes, that's true.

R9: And if man is managing it, it will fail. Sometimes, in my talks, I mention the… do you know about the old Seat advert?

I: No, I can't remember it, no.

R9: Well, basically, it said: 'Designed by computers – Built by robots – Driven by Italians.'

I: Yeah, that's good [laughs]!

R9: And, I think that that sums up environmental risk management. [1581]

Despite being difficult to manage, this chapter has shown that environmental due diligence is now prominent throughout the whole life of a loan, and the data provide evidence that the use of environmental due diligence in banks is particularly important when dealing with certain operational sectors. The use of due diligence is also important in the situation where a client is no longer able to repay the loan, or where environmental issues threaten the asset that has been secured against the loan by the bank. The application of due diligence during a borrower's insolvency also helps the bank to decide whether foreclosure is a feasible option.

[1581] Interview with Respondent 9.

So, 'when' in the lending process is the conduct of environmental due diligence most important? Fordyce, Kofman and Tay believe that the use of due diligence is most important before the loan has been contracted out:

> 'Environmental liability is only one of many considerations which a lender should consider in making credit determinations. The easiest time for the lender to protect itself is before the funds are advanced or a commitment is made to lend.' [1582]

As with the above quote, the majority of interviewees agreed that the conduct of environmental due diligence is of the utmost importance before the loan has been created. This viewpoint is demonstrated well by the answer that Respondent 6 gave when asked this question in interview:

> *I: So, when is the use of environmental due diligence most important, you know, at what stage of the lending process do you think?*
>
> *R_6: I think it's most important to do it right up front because once you have the property, and once they have the money in hand, it is much harder to get the client to do what you want them to do, because the carrot, so to speak, is that you'll get the loan if you do all of these things. That's more effective that the stick would be if they have already had the loan already invested, or already spent the money.* [1583]

[1582] Fordyce, Kofman and Tay (n 80) 21.
[1583] Interview with Respondent 6.

The threat of being made directly liable for historic land contamination has cemented the *caveat* of 'the buyer beware' into the minds of the UK's lenders. This is why most environmental risk teams are still concerned about the threat posed to the bank by environmental issues emulating from the pollution of land and controlled water systems. Screening contaminated land at the preliminary stages of a loan helps lenders to get a feel for the scale and significance of the contamination situated upon a site. It also helps bankers to decide whether they should assign property value and security to such sites. Accordingly, 'getting it right from the start', is an important proviso for banks to follow.

While the interview data show that the use of environmental due diligence is most important prior to the loan being permitted, the thesis has also attempted to portray why post-loan due diligence is also essential for resolving the 'control dilemma', and other issues which tend to emerge after the loan has been approved. During the pre-loan due diligence stage, banks are always trying to ascertain whether a loan is financially viable, and free from risk. However, lender liability is most likely to occur in the situation where there is a significant material change in the borrower's operations after the grant of the loan. Hence, managing the risks after the loan has been allowed is, in many ways, just as important.

IV. The Continued Growth of Due Diligence

This section uses empirical data to answer sub-question 3, point 3, i.e. 'What is the future of environmental due diligence in UK banks?' During the analysis stage, the data that were necessary for this section were highlighted in yellow and underlined in black.

Although a necessary part of the lending process, environmental due diligence still remains only a minor feature of the overall risk management functions within banks. Presenting the interviewees' perceptions of the continued growth of due diligence in the environmental context helps to explain why direct lender liability risk is currently perceived as the least likely threat. It also helps to understand how environmental risk management will evolve in banks over the next few years.

Respondent 11, for instance, believes that environmental risk management is only a small part of banks' due diligence functions, and cleverly compares its application to the role of a canary in a coalmine:

> *R_{11}: Environmental risk may be the canary in the coalmine. It's one of a range of risk factors that a bank might want to consider and monitor, which will demonstrate the customer's broader governance and business viability.*[1584]

After analysing the interview data, it appears that the majority of the banking respondents believed that environmental due diligence has an essential role to play in banks' overall risk management functions. However, while important, this role is only small, like the canary in the coalmine. Despite its small role in bank lending, the majority of interviewees suggested that environmental due diligence is set to continue growing in importance in banks for some time to come. The main question that lenders are asking themselves now is: To what extent will environmental due diligence continue to grow? In relation to questions concerning the continued growth of environmental

[1584] Interview with Respondent 6.

due diligence, Respondent 10 asked whether, in the future, environmental risk management in commercial banks would ever become as developed as the project lending banks, whose environmental risk management is particularly well established because of the nature of their lending practices:

> *R_{10}: So, the question is whether commercial banks will ever get to a stage where they develop the scale and coverage in their teams ... in their environmental teams ... to the likes of development banks?*[1585]

Obviously, this chapter will be unable to answer these questions here, but it can nevertheless provide data in order to depict what the interviewees, the people working with environmental due diligence methods on a day-to-day basis, think may happen in a couple of years' time. While the interview data merely capture a moment in time, there is a sense of unity between the interviewees' ideas concerning the future application of environmental risk management and bank lending. The following examples illustrate what the majority of the interviewees think may happen to environmental risk management in banks in some years to come:

> *R_1: You never know! You never know! And that's why environmental risk is here to stay. Because, if the regulatory framework changes, then, suddenly, they give the local authorities the ability to investigate special sites, then the whole ball game could change in a year or so. So, what you got to have*

[1585] Interview with Respondent 10.

is a system in place that manages and mitigates that risk, but is able to adapt to that risk. [1586]

Furthermore, Respondent 5 said that, because the threat of the environmental risks is growing, so too is the importance of the reasonable use of environmental due diligence in banks:

R_5: Due diligence is getting more and more important. If anything, it is acquiring greater importance for a number of reasons, as far as I can tell: one is that environmental risks are becoming greater. When I started, "climate change" was not even in the technical vocabulary of those in the field, and only a few of us in the field really understood "sustainability", for example… So, if anything, I think that due diligence is broadening its scope; it is not just looking at, "Is this site contaminated, and what will it take to remediate it?" It also looks at how a company is performing and what is their role in climate change and combating climate change: Are they a part of the solution or the problem? [1587]

Respondent 9 suggested that environmental due diligence has 'a big future':

R_9: I think that there is a big future for it. But what I did think is that we have to go with the times and that we have to go with the risks: the due diligence has to go with the risks. [1588]

[1586] Interview with Respondent 1.
[1587] Interview with Respondent 5.
[1588] Interview with Respondent 9.

And, finally, Respondent 10 emphasised:

> *R_{10}: Well the future is that it is certainly here to stay; it is also here to grow. The question is: To what level will it grow? ... I think the future is safe for environmental due diligence. It is here to stay, it is here to grow, and it is here to become more important. Although, it also has to become more professional amongst banks, and it will become more professional and professionalised as well. But, I don't think it will be a mainstream business for the bank, to do environmental due diligence; it will always be a side activity to mitigate risks.* [1589]

After analysis, a universal theme concerning environmental due diligence's future in banking could be established throughout the whole of the interview data. This theme suggests that environmental due diligence is no longer being primarily driven by the threat of incurring legal exposure as a result of contaminated and suspect land; however, this may change if the hanging sword that is Part IIA is dangled more effectively in the future.

Despite the decreasing threat posed to banks by legislation, due diligence for environmental issues is progressively beginning to broaden itself in order to accommodate for the emerging environmental risks. Although it is questionable whether the impact of climate change will have a significant effect upon banks' loan financing activities, over the course of the next twenty to thirty years there will be a tipping point where business viability will be affected by such things as the rise in sea

[1589] Interview with Respondent 10.

levels, or the atmospheric effects caused by air pollution, etc. Accordingly, one must look at environmental due diligence in lending practices as a moving agenda that needs to constantly adapt, and update itself, in order to respond to growing environmental risks. In terms of environmental due diligence's function in the banking system, it is unlikely that the size of the environmental risk management teams will greatly increase at any point in the near future, however. What is more likely to happen, is that the banks' environmental risk teams will become more refined and have a wider application.

After looking at the beginnings and development of environmental due diligence in banks, since the 1990s, it will be interesting to see in future research how environmental due diligence, and the bankers' perceptions of environmental risk, will change: for example, will environmental risk still be described as the 'canary in a coal mine' in twenty years' time?

V. Conclusion

This chapter holds a lot of data in comparison to the other chapters of the thesis. It is, therefore, where the empirical study's main findings are presented. Displaying the data in such a way was necessary, since the originality of the thesis may be claimed as a result of the insights of the banking respondents. The chapter began by assessing the when, why and how environmental due diligence had emerged within financial institutions. It attempted to answer the question of, what drove and continues to drive the paradigm shift in the lenders' due diligence functions? The interview data have demonstrated that the primary driver for change came from the enactment of specific

legislative exposures, like Part IIA, during the 1990s and early 2000s. Nowadays, however, the banks' reputations and image in the public eye have become the primary drivers for the continued use of environmental due diligence. The financial crash, which caused significant financial loss for banks, also damaged the banks' standing in the public eye; this may have caused greater harm in the long run, as the public at large has lost much faith in banks.

When asked about the importance of environmental due diligence, the interviewees unanimously agreed that, albeit it is only a small part of banks' risk management functions, environmental risk management is going to continue to grow because banks will need to respond to, what was described in Chapter 3 as, the emerging environmental liabilities such as climate change and flooding.[1590] The interviewees also agreed that environmental due diligence is most important before the loan is approved. The chapter showed that post loan due diligence is also essential for reducing the banks' exposure to environmental liability and risk. After a loan is granted, lenders must always be cautious about the amount of control that they may have over their borrowers.

Chapter 8 concludes the thesis. It discusses both the primary and supplementary research findings. Following this, a possible solution for increasing the lenders' role in land redevelopment is presented.

[1590] Refer to ch 3, pp 181-191.

Chapter 8:

Discussion and Conclusion

This thesis contributes original data to the research area. In light of the knowledge gaps that existed in the research field, and the Coalition Government's 'reduce red tape' strategy in the period of austerity, it was decided to conduct empirical research to assess the lenders' current perceptions toward environmental risks and due diligence. The direct lender liability threat arising out of the law relating to land pollution is considered an unlikely risk for banks. In contrast, reputational harm by virtue of being in association with a polluting borrower or project is viewed as the greatest environmental risk to lenders, in terms of its likelihood of occurring and the severity of harm that the bank could incur.

Lenders must not lose touch with the inherent problems that will always remain with possessing, or having a borrower in possession of, an environmentally suspect site. Banks are currently holding 'toxic assets' within property portfolios;[1591] these assets have either been left over by insolvent borrowers, or purchased by the bank as an investment during a bull market. As the economy starts to regain some momentum banks will have to sell off their distressed assets; and some of these assets will include land that is subject to environmental risks. Already there is evidence to show that banks

[1591] K Allen, 'RBS sells first distressed UK commercial property assets' *Financial Times* (London, Friday 6 December 2013) <http://www.ft.com/cms/s/c2d4a4ca-5d9d-11e3-b3e8-00144feabdc0,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2Fc2d4a4ca-5d9d-11e3-b3e8-00144feabdc0.html%3Fsiteedition%3Duk&siteedition=uk&_i_referer=http%3A%2F%2Fjournalisted.com%2Fkate-allen-2%3Fallarticles%3Dyes#axzz3FRjlm2By> accessed 7 October 2014.

divest themselves of such property. For example, in an article for the *Financial Times* Allen suggests that:

> 'The Royal Bank of Scotland's property portfolio of distressed UK commercial property assets, in a sign that the bank is managing to unwind its troubled investments. The 28 industrial distribution units in the 2m sq. ft. "Sapphire" portfolio were previously owned by various RBS borrowers and had a guide price of £63m.'[1592]

On the one hand, this research provides the most up-to-date account of UK lender liability and environmental risk in the period of austerity; on the other, the research is likely to be even more pertinent if and when the financial market regains its strength. This is because the thesis shows how direct lender liability for land pollution, although considered low risk, still remains a threat to lenders. Because of this existing threat, banks need to remain vigilant in their environmental due diligence. Also, while the potential solution, outlined at the end of this chapter, is meant to help to encourage land redevelopment during the economic downturn, it should similarly be applied to a bullish market with renewed activity in brownfield land development.

This chapter provides a discussion of the thesis' main research findings as well as its implications to theory, practice and future research. Following this, a more nuanced solution for increasing the lenders' role in land redevelopment is outlined.

[1592] ibid, 27.

I. A Summary of the Research Findings

The principal research finding can be summarised simply: while the environmental legal basis has created an insufficient direct lender liability threat for bank lenders over the last decade, there has inevitably been an increased focus on environmental risk management within banks. This is evidenced by the pre- and post-loan due diligence techniques which are now deeply entrenched within banking practices. Whereas previous literature found that environmental due diligence in banks was originally driven by the threat of direct lender liability from environmental legislation, data collected by this research show that this is no longer true, and that the creation of environmental policy in banks is now being pushed by: (1) the indirect risks, i.e. credit and security risks; and (2) the threat of reputational harm. Chapter 7 provides the richest source of empirical data.

The research's primary and secondary findings are summarised and discussed further below. The research questions from Chapter 1 are incorporated into the text. Clear reference is made to the way in which each chapter has answered the overarching research question along with the individual sub-questions.

A. Environmental Risks

The research findings displayed in Chapters 1, 2, 3, 4 and 5 are essential for answering the key research question and sub-question 1, which both ask what the most threatening environmental risks for banks are today. The relevant interview data concerning the

environmental risks were placed into the green coding category during the analysis stage; the individual bullet points were underlined accordingly (see Chapter 1).

Section II of Chapter 1 outlines the literature basis surrounding this research area. The early literature reveals that the greatest environmental risk for banks was lender liability, and, in particular, the liability threat from Part IIA of the EPA. In contrast however, the modern writings suggest that lender liability for land pollution has now been replaced by reputational risk as the most likely and severe environmental risk. The literature explains that the legal basis concerning environmental protection has created no real legal liability risk for lenders in the UK; banks have now become accustomed to assessing legislative non-compliance risk within their day-to-day dealings. Although Part IIA was never designed to replicate CERCLA's direct approach, many law practitioners and academics have nonetheless questioned the successfulness of the regime. The literature makes it clear that other things must now be driving environmental risk management (see below).

Section III of Chapter 1 concerns the affect that the Coalition Government's public sector cuts have had to the enforcement of the contaminated land regime. Due to the nature of the Coalition's austerity agenda, widespread public sector cuts have been made for the identification and remediation of contaminated land. The ability of the regulators to enforce their statutory duties under Part IIA has been weakened significantly as a consequence. Therefore, the economic overview in Chapter 1 delivers an economic account for why Part IIA is now considered low risk by lenders, and replies to the key research question and to sub-question 1, specifically.

Chapters 2, 3 and 4 offer an important procedural component for the research. Any data concerning the environmental legal basis and its risk to commercial lending were placed into the green coding category and underlined in blue pen. The detailed overview of the contaminated land regime in Chapter 2 is necessary for answering the element of the key research question which concerns whether environmental law is a real direct risk for banks. Will a lender ever attract liability under Part IIA of the EPA? Building on from the literature review and economic overview in Chapter 1, Chapter 2 delivers a legal analysis for why this is an increasingly unlikely possibility. The contaminated land regime was not designed to allocate direct liability to a large number of appropriate persons, as it applies to only the most significantly contaminated sites. Also, in an effort to cut the red tape, the revisions that have been made to the Part IIA regime have placed the regulators in a weak position to exercise their statutory duties. For these reasons, the Part IIA regime is viewed as a highly unlikely risk. And such a research finding provides an answer to the overarching research question and sub-question 1.

Additionally, in answering the overarching question and sub-question 1, Chapters 3 and 4 support the research findings in Chapter 2. These chapters portray that the threat posed by the other, national environmental laws relating to land pollution is (like Part IIA) a sufficiently low risk for lenders. In practice, banks are most at risk if they take possession of contaminated property by foreclosing their securities. But this is a very unlikely possibility in the present day, given the widespread use of environmental due diligence in banks. Indeed, the prudent bank would simply abandon the property where the environmental risk assessment suggests on-going contamination.

Sub-question 1, point 2 tests how lenders currently rank the environmental risks in terms of their likelihood of occurring and severity of harm. Chapter 5, section II

answers this sub-question by presenting data which rank the current threat of the environmental risks. The risk ranking model outlined in Chapter 5 is as follows: first, lender liability – low risk; second, the indirect risks – medium risk(s); third, reputational risk – high risk. Even before the qualitative study was undertaken, a review of the literature meant that these results were to be expected. Though the risk ranking model is largely associated with point 2 of sub-question 1, it also bears relevance to points 1 and 3, and was coded accordingly. The contemporary risk ranking presented in this research provides evidence to show that environmental legislation is no longer deemed to pose a real risk to lenders, and that there are other risks that can threaten commercial lending transactions. What is more, the data that are held in Chapter 5 have illustrated how the lenders' perceptions have changed over the last twenty-five years, thereby answering the overarching research question and sub-question 1. Depending on relevance, some of the data were coded green and red (sub-question 1, point 2); and others were coded green and black (sub-question 1, point 3).

There were a number of unexpected research findings in Chapter 5 concerning environmental risks which were both interesting and exciting. First, the interviewees' perceptions of the 'emerging liabilities' are a vital finding for answering the overarching research question. Not only does such data clarify where future research opportunities in this socio-legal field lie, but it also captures the direction that environmental risk management may take in years to come. Such data also answer the research question concerning the more threatening environmental risks (sub-question 1), as well as the present drivers for the use of environmental due diligence in banks (sub-question 3).

However, it must be noted that environmental risk management may develop in a way that is unexpected, and totally different from, the opinions expressed by the research subjects. Without being able to predict the future, this research has – through the qualitative data that has been collected – captured a moment in time, and has presented the findings in order to contribute to the knowledge of this particular area. The banking respondents' insights offer a unique and original contribution to the research field. Secondly, another unexpected finding with regards to the description and categorisation of environmental risks, was the recurring inclusion of 'market risk' as an environmental threat. The interview data show that, when mentioned, many of the interviewees ranked this as the least likely environmental threat in bank lending. Reasons for not including this risk are presented at the end of Chapter 5.

B. Environmental Due Diligence

The applicable chapters for answering the part of the overarching research question and relevant sub-questions concerning environmental due diligence are Chapters 6 and 7. The thesis shows that environmental liability is, today, considered low risk to commercial lenders. The overarching research question asks, '… what are currently the primary drivers for the use and development of environmental due diligence in loan finance transactions?' Chapters 6 and 7 answer the overarching question and sub-questions 2 and 3 by defining how lenders currently use environmental due diligence to manage environmental risks. Unique interview data are used to evaluate the various drivers for the continued practise and development of environmental due diligence in banks, and to identify the main driver at the current time of writing.

In order to provide an overview of the drivers of environmental due diligence, it is first necessary to outline the various due diligence techniques that are used by banks to manage environmental risks. Data which were relevant to this topic were coded into the blue and blue coding category (see Chapter 1). Chapter 6 describes the main due diligence techniques that are used by lenders to process environmental risks, as well as the different stages of environmental due diligence in banks. The chapter identifies that banks use a range of due diligence methods to manage environmental risks. While this finding may be a predictable and, in many ways, self-evident truth for people with knowledge and understanding of banking risk management and due diligence, it is nevertheless interesting to see how this specific due diligence culture has evolved since the 1990s / early 2000s. Indeed this research finding acts as an important source of information for answering sub-question 2, i.e. 'How do lenders exercise and shape their due diligence functions to manage and assess the environment-related risks?'

Another important research finding concerns 'when' in the lending process environmental risks are assessed. In answering sub-question 2, point 2 the data show that environmental due diligence is deployed both before and after the grant of loan finance. At the analysis stage, all of the data that were necessary for answering this sub-question were coded in the blue and red category, and are held in Chapter 7, section I. This section of the chapter is relevant to the overarching research question. It demonstrates how environmental risk management has evolved in banks in response to the threat from legislative non-compliance risk. Throughout the analysis data were highlighted in blue and underlined in black, and respond to sub-question 2, point 3. All of the banking respondents acknowledged that the most important time to conduct due diligence was before the loan is contracted out; but the ability to employ post-loan due

diligence techniques continues to remain an important feature in the management of environmental risks.

Both the overarching question and sub-question 3 ask, 'what are the primary drivers for the use of environmental due diligence?' Chapter 7 presents the core data that offer original and unique insights into what has driven the increased environmental risk management culture in banks based in the UK. The data held in Chapter 7, section I fall into the yellow and blue coding category, and show that legislative non-compliance was initially considered to be the primary driver for environmental due diligence in banks in the 1990s. The data go on to illustrate, however, that the ability of legislation to drive environmental risk management in banks is decreasing in significance. Incidentally, legislative non-compliance has now been largely replaced by reputational risk as the primary driver. The data in Chapter 7 are thus important for answering the overarching research question and sub-question 3, points 1 and 2. It is noteworthy that data specifically relating to the present drivers of the lenders' use of environmental due diligence were highlighted in yellow and underlined in red.

The final coding category (yellow and black) relates to sub-question 3, point 3, i.e. 'What is the future of environmental due diligence in banks?' and the answer is presented by data found in Chapter 7, section IV. The interviewees unanimously agreed that there is a future for environmental due diligence in banks, and that this form of risk management is highly likely to grow in significance in years to come. Nowadays, however, the lender liability risk from land pollution is giving way to the potential threat that may exist from other, emerging, environmental liabilities, i.e. climate change and flooding. By concluding that lender liability for land pollution is no longer the

primary driver for the future expansion of environmental due diligence, this research finding is vital for answering the key research question.

Nevertheless, despite the changes in the lenders' perceptions of environmental risk and due diligence over the last decade, new environmental problems are emerging all of the time, and the laws that are in place may be unsuited to regulating emerging particular problems.[1593] Thus, environmental regulation will always remain a risk to banks, no matter how much the environmental risk teams think that they have a handle on issues surrounding legislative compliance.

C. Lenders, Environmental Law and Insolvency

A supplementary – and somewhat unexpected – finding to this research project was the environmental risks that could emerge for lenders because of their borrowers' corporate insolvency. This chapter displays how environmental law can sometimes be undermined by more established regimes. Chapter 4 supplements Chapter 2 and is relevant for answering the overarching research question and sub-question 1. This is because it shows that environmental legislation is presently conceding ground against more established legal regimes, and presents lender liability as low risk. The data relevant to this topic were highlighted in green and underlined in blue during the analysis stage.

[1593] See, L Frater, E Stokes, R Lee and T Oriola, 'An Overview of the Framework of Current Regulation affecting the Development and Marketing of Nanomaterials: A Report for the DTI' (2006) ESRC Centre for Business Relationships Accountability Sustainability and Society (BRASS), URN 06/2220 <http://webarchive.nationalarchives.gov.uk/20090609003228/http://www.berr.gov.uk/files/file36167.pdf> accessed 21 August 2014.

Only one interview participant (Respondent 3) spoke about the environmental threats that may emerge because of their borrower's insolvency, which may suggest that this issue is not being considered in any amount of depth by banks. The interview with Respondent 3, who had previously worked as an insolvency practitioner, led to an entire chapter (Chapter 4) on the material uncovered in that interview. The conversation that took place demonstrated that there is a significant overlap between the relevant laws surrounding insolvency, and the environmental licensing regime for regulating activities relating to the management of waste. It also exposed the fact that lenders are aware of the problems that may stem from the conflicting legal regimes. However, in an age that encourages the recovery of companies that fall into insolvency, another surprising result came from Respondent 3's opinion about the lenders' preferred insolvency procedure, which consists of liquidating the company's assets and allowing the winding-up of the debtor company. Although a surprising result, such an attitude does make sense from the lenders' point of view, because, even though the liquidation procedure does not aim to rescue the company (as advocated by Enterprise Act 2002), it does provide a quick, clear-cut return for the company's secured creditors.

II. Implications of the Findings to the Research Area

This research has generated a number of implications for theory, research, and practice in the research area covering lender liability and risk for environmental damage. This section provides an account of this impact.

'Theory' – Through the insights of the interviewees, this research provides an original contribution to the knowledge of this research field. As previously mentioned, the

theoretical basis concerning environmental risk and due diligence comes from a body of writing that is now largely out-dated. More recent work is more reflective of the current situation, although findings on the lenders' perceptions of environmental risk and due diligence are still in need of more up-to-date empirical analysis. This research project confirms, by using the qualitative data collected and analysed, that the older literature's assessment of environmental risk (e.g. regarding direct liability as the most threatening environmental risk for lenders) is no longer an accurate portrayal of the lenders' present risk ranking. Nowadays, reputational risk is perceived as the greatest threat to corporate bank lending. This work has also shown how banking due diligence is slowly beginning to change in order to adapt to emerging environmental threats.

'Practice' – It is hoped this research will have practical implications for a number of different fields. With regards to the political-legal field, Chapter 1 shows how the Part IIA regime has been severely impacted by the economic recession, and the political decisions of the Coalition Government. The reduced support of the public sector for contaminated land identification and remediation is significantly detrimental for the regulators of the Part IIA regime, who will now find it increasingly difficult to fulfil their statutory duties. Furthermore, private sector investment in the funding of the redevelopment of environmentally suspect land is also likely to decrease, since lending to such projects has become increasingly risky (in terms of the indirect and reputational risk that could be incurred). Thus, there is need for a nuanced solution that encourages the lenders' role in land redevelopment. This is outlined in the next section.

'For Future Research' – There are a number of future research opportunities that may stem from this study. First, it is evident that similar research needs to be conducted in

the US, and in emerging markets. A comparative piece on the USA and China, for example, would be valuable in advancing the insights provided by this thesis. This is because these two countries have very different approaches to environmental risk management in banks. While the US bank lenders take more of a 'liability' based approach to environmental due diligence, Chinese banks have looser policies towards environmental risk. It would be interesting therefore to compare the research findings in this thesis with the perceptions of risk in these countries. Secondly, this research could provide a springboard for research investigating how ethical and social impacts have affected the banking structure. Finally, the insights presented by the data within this research could be revisited in a number of years' time. Such a project could show how environmental risk and due diligence has changed since 2014, and the impact that the 'emerging risks' (which are outlined in this project) have had upon lenders since this current time of writing.

Now that the implications of this empirical study have been assessed, the next section provides a nuanced solution for increasing the lenders' role in land redevelopment.

III. In Search of a Solution

This thesis has established that brownfield land redevelopment is presently facing a number of challenges. Such challenges have been intensified as a result of, *inter alia*, decreased public sector support in funding economic incentives for suspect land clean-up, and the weak enforcement of the environmental laws relating to land pollution. Currently, there is no encouragement for redevelopers to remediate suspect land. In Chapter 1, it was shown that brownfield land remediation is important for the UK,

which has a high population density, and a shortage of housing. The lenders' role in land redevelopment (i.e. as the funders of regeneration projects) could provide the answer for increasing the redevelopment of brownfield land. Accordingly, this section outlines a possible solution for encouraging future land redevelopment. It does this by focusing on two primary elements: (1) the law's future application; and, (2) a move towards a more symbiotic approach between the private and public sectors.

In the law's application, it actually makes sense for direct lender liability to remain low risk. If, in the near future, the law relating to land and water pollution is applied too strictly, this may hinder some borrowers (e.g. the high-street dry cleaners, or the single-site petrol fuelling stations) when applying for loan financing. Future politics must not seek to encourage land redevelopment through a regime that commands compliance by making direct liability exposure a likely, and severe, occurrence. One that has learnt from the trans-Atlantic mistakes of the past would suggest that the direct approach to the remediation of polluted land is, in fact, counterintuitive. Ideally, Part IIA's thresholds should remain high, and the *polluter pays principle* should be followed at all times. Therefore, in answer to the first question, it seems that imposing the remediation of environmentally suspect land through a regime of direct lender liability could be extremely damaging to the banks' role in funding land redevelopment projects. In consequence, this research neither supports, nor encourages, a strict, direct lender liability approach towards environmental clean-up. The reason for adopting this stance was explained in Chapter 2, where a chronological account of the development of the law relating to historic land contamination is provided. By analysing the development of this area, the origins of lender liability and environmental risks occurred in the USA, in the 1980s, with the bringing into force of CERCLA. As previously outlined, under

CERCLA a number of lenders were found directly liable for the environmental pollution of their borrowers' hazardous waste sites. During the 1980s and 1990s, US lenders became fearful of lending their money in case they became subjected to CERCLA liability, the remediation and reputational costs of which could be substantial.

Following this, the question still remains as to how it might be possible to circumvent the use of direct lender liability, while effectively enforcing contaminated land remediation? As an alternative to direct lender liability, a more nuanced approach needs to be taken when dealing with environmental risk and remediation. This approach should not make banks fearful when lending to certain clients, nor should it prevent borrowers from receiving loan financing because of environmental issues. In so doing, it should also seek to regain public sector confidence in the remediation of land affected by contamination. Without doubt, the decreasing financial support for contaminated land identification and remediation from the public sector has significantly impacted the local authorities' enforcement of the Part IIA regime. After the first bout of cuts were made to the economic relief that was provided for the developers and owners of contaminated land, local authorities have had little incentive to pursue their statutory duties. For example, since 2010, twenty three per cent of local authorities did not receive any funding, and fifty-three per cent were given less than £5,000.[1594] Also, in relation to the regime's enforcement, eighty-three per cent of local authorities have not carried out any intrusive site investigations since April 2012, when the new statutory guidance was released.[1595] The reduction of funding to England will inevitably mean that even fewer determinations will now be made by local authorities, who are

[1594] 'Part 2A contaminated land regime – has the dragon lost its fire?' (*ELM Law*, 22 July 2013) <http://www.elmlaw.co.uk/post.php?s=2013-07-22-part-2a-contaminated-land-regime---has-the-dragon-lost-its-fire> accessed 10 February 2014.
[1595] ibid.

becoming increasingly reluctant of paying for the remediation costs of the contaminated land that is situated within their areas.[1596]

In the move towards a symbiotic approach, perhaps the answer for driving the continued commitment to suspect land remediation lies not in direct governmental intervention through legal regulation and administration, but, rather, through a state which encourages environmental governance between the private and public sectors.[1597] The literature concerning the 'greening of finance' (i.e. that the environment and economy are 'interrelated'), in Chapter 1, supports the need for a co-operative approach between the government and private sector investors. Following Gunningham et al.'s notion of 'Smart Regulation',[1598] Richardson suggests that, 'Since environmental protection is not a self-contained policy issue but permeates many sectors, then the concentration of responsibilities within a single specialist agency is not necessarily desirable.'[1599] While there are a number of limitations to this symbiotic approach (e.g. retaining coherency between the state, law and markets may become an issue at times),[1600] it is nonetheless a much more pragmatic mode for reducing environmental problems in the twenty-first century than more traditional methods. With regards to regulating contaminated land, specifically, it seems likely that the creation of a 'shared space of governance'[1601] would provide the necessary stimulus for driving clean-up efforts. Further to greater co-operation, lenders should soften their policies so as to encourage brownfield

[1596] ibid.
[1597] Richardson (n 324) 3. See also, *inter alia*, I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (OUP 1992); DF Kettl, *Sharing Power: Governance and Private Markets* (The Brookings Institute 1993); P Self, *Government by the Market? The Politics of Public Choice* (Macmillan Press 1993); G Stoker, 'The New Governance: Governing without Government' (1996) 44(4) Political Studies 652.
[1598] N Gunningham, P Grabosky and D Sinclair, *Smart Regulation: Designing Environmental Policy* (Clarendon Press, OUP 1998).
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development. They could, for instance, reduce loan interest rates for developers aiming to remediate contaminated properties as a means of incentivising suspect land redevelopment. The problem, however, is that there is no reason for the banks to do this at the moment. This thesis therefore argues that the government must work towards rebuilding the confidence of the banks, developers and landowners operating within the contaminated land market.

IV. Conclusion

In conclusion, contaminated land pollution should not be neglected simply because new risks are emerging, and the laws relating to land and water pollution have created an insufficient direct liability threat. Public policy would suggest that redeveloping land is beneficial for a number of reasons, e.g. reducing development on the greenfield, minimising prospective environmental risks, and creating jobs and economic growth. Given this time of financial hardship for local government, this thesis proposes that future politics must continue to prioritise brownfield land redevelopment. This links back to the section in Chapter 1 which discusses how land availability may become an issue in the near future. A middle ground must be established between the government and private sector banks, otherwise forthcoming property development will continue to bear heavily upon the UK's green spaces. It is hoped that a co-operative approach to land redevelopment would mean that the risks that can occur when redeveloping suspect land are not only shared, but are also significantly reduced in the process.

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Appendix 2:
Pro Forma Documentation

1. Information Form

***Please read this information carefully before you sign the consent form (below)**

Thesis Title: *"The Lenders Role in Land Redevelopment"*

1. The research is being conducted by Lloyd Brown (a PhD student at Cardiff University) and concerns the potential risks (both direct and indirect) that may attach to lenders when dealing in commercial land transactions on contaminated and brownfield sites. The purpose of this empirical study is to gain an understanding of the financial institutions due diligence methods with regards to environmental risk transfer.

2. The project is funded through the Knowledge Economy Skills Scholarship (backed by European Structural Funding) and is conducted by Cardiff University with Ashfield Solutions as a collaborative enterprise. This funding expires after a period of three years, so there is urgency for its completion.

3. The empirical basis of the study consists of semi-structured interviews (i.e. an interview based on a broad topic list of relevant topics).

4. It is estimated that the interview will last around 45 minutes. The interviewee may choose not to respond to certain questions. The participant's contribution to the project is unpaid and voluntary; the participant may opt-out at any time before and during the interview. The student would like the interviews to be recorded by an electronic device

to aid in the transcribing process. You may decline the use of any recording equipment in the interview.

5. The qualitative study is designed to ensure that the information given by participants will remain confidential post-interview. Participants can be assured that all the information will be anonymised and that the handling of the "personal data" during the analysis phase will be done in accordance with the Data Protection Act 1998. The student assures participants that it will not be possible to know who engaged in the interviews on reading any part of the thesis, or associated publication

2. Consent Form

***Please read the information form before signing**

I (Participant's Name) have read the information form and understand that my participation in the research project is on a voluntary basis. By signing this consent form I have expressly agreed to participate in the interview out of my own free will on the basis of the assurances of confidentiality given to me.

Name (printed):_____

Signature:_____

I have agreed to allow this interview to be recorded.

Signature:_____

Date:_____

Appendix 3:
Topic List

Introduction

- Preliminary proceedings:
  - Introductions;
  - Confidentiality issues & the use of electronic recording etc…
- Environmental DD and Drivers…

Risks

- The Risks?
- Are some risks more of a threat than others?
  - Direct – Mortgagee in Possession
  - Indirect – credit; security; & reputational risks

Lenders DD & Assessment of Eligibility

- Implementation of environmental laws and regulations?
- How does one mitigate for risks?
- Different types of commercial clients?
- High risk Clients?
- Mechanisms for allocating environmental risks:

1. Pre-foreclosure

   - Analysis of client's eligibility;

- Use of internal committees;
- Conditions precedent in loan documentation -Warranties; Indemnities; Environmental Insurance etc.
- Environmental reporting;
- Use of external expertise.

2. Post-foreclosure

- "Control";
- Administrator;
- Assessment of risk;

Future for Environmental DD

- What is the future?